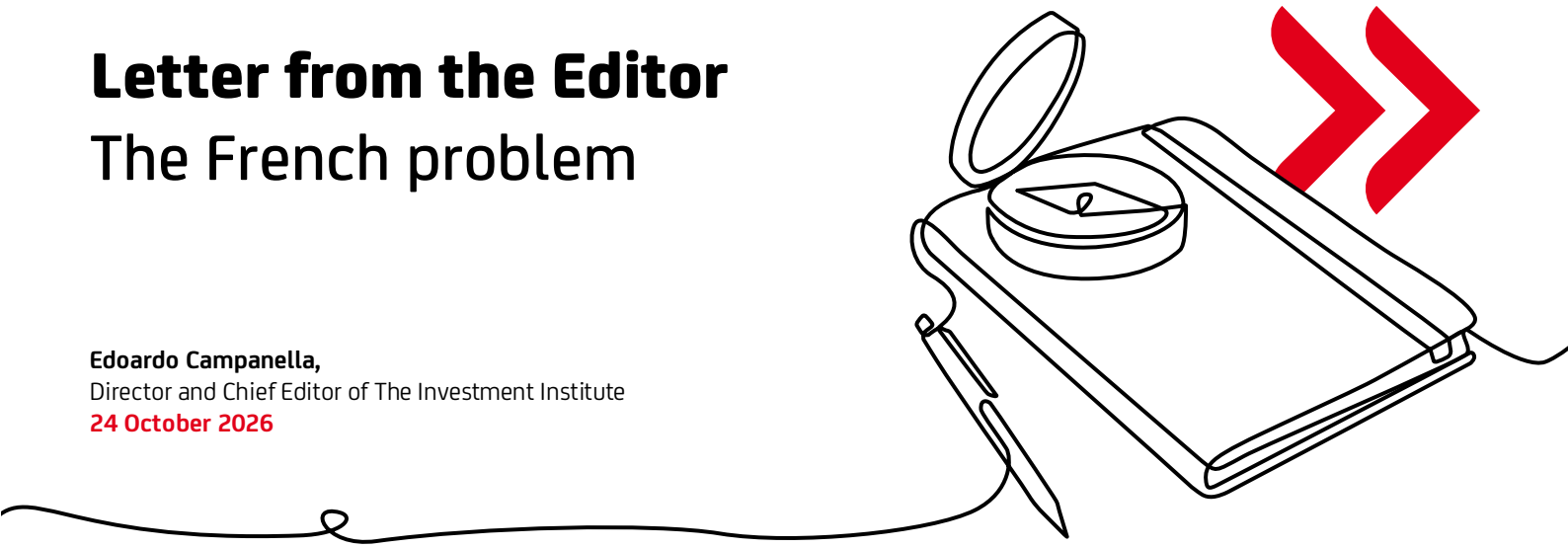
The Investment Institute
by UniCredit

Letter from the Editor
The French problem



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Letter from the Editor is our weekend read, which looks at the big picture, one question at a time.

France's inability to redesign its welfare state in a fiscally sustainable way is at the heart of current market tensions. Reforming the pension system, in particular, is the great political taboo both on the left and the right. The problem is that France, like Europe in general, is approaching the ageing of its population in the wrong way, viewing it as a fiscal burden rather than a growth opportunity. Longevity, if properly approached, could become one of the greatest sources of economic growth and prosperity in the 21st century. But only if we rethink what it means to live longer.

Hello from the Investment Institute

French philosopher Raymond Aron once observed that the French are a people who from time to time make revolutions but never reforms. The notion that France is unreformable is widespread, not only among investors but also within the French political elite. A few months after winning the presidential election in 2017, Emmanuel Macron said: "France is not a reformable country. Many have tried and failed because the French hate reforms."

The clearest illustration of this dilemma is the pension system. France, like all of Europe, is facing the difficult reality that longer life expectancy and low fertility make pension reforms unavoidable. Yet when Macron sought to raise the statutory retirement age from 62 (one of the lowest on the continent) to 64 in 2023, the country erupted in protests. Marine Le Pen has promised to keep the retirement age at 62 if elected president next spring, while Jean-Luc Mélenchon has pledged to lower it even to 60.

France's inability to reform is preventing the country from doing what markets expect it to do: bring down public spending, which stands at around 57% of GDP (almost 10pp higher than Germany's), while reallocating resources away from the old to the young. As a result, yields on 10Y OATs exceeded 5% in a week when government bonds for major economies rallied, while the spread to Bund rose to levels last seen during the eurozone crisis in 2011. To calm investors, Paris needs to overcome its anti-reform mindset and send a strong signal to global markets.

However, rather than dwelling on the market themes that have occupied investors this week, let me use France's current predicament as a starting point to discuss a broader issue, namely how France, and Europe in general, should rethink the ageing of their population. A few weeks ago, I argued that higher defence spending is unlikely to be financed through cuts to social expenditure. Today, I would like to focus on the demographic dimension of the same challenge that could free up fiscal resources:

Is Europe getting the ageing of its population right?

My take is that it is not. Too often, ageing is viewed primarily as a fiscal burden rather than as a potential engine of growth, innovation and economic contribution. Europe's debate tends to focus on how to finance people living longer and not how to make longer lives more economically valuable. The positive dimension of longevity tends to be overlooked and nowhere is this more evident than in the pension debate in France. These are some of the topics that will be discussed during various events on longevity hosted by UniCredit across Europe, with a flagship conference taking place in Frankfurt on 9 November.

Not for Bismarck

When Otto von Bismarck introduced Germany's old-age social insurance system in 1889, the first of its kind in the world, he set the retirement age at 70, at a time when life expectancy at birth was just 39. Very few people ever reached retirement. In the decades that followed, Europe gradually pushed this social experiment to its limits, with France standing out as one of the most extreme cases.



Ageing and longevity are not the same thing.

In 1970, France's average effective retirement age was 68. At the time, a 65-year-old could expect to live to around 79. Yet while life expectancy continued to rise in the following decades, the effective retirement age steadily declined, reaching 59 by the late 1990s and remaining around that level until the eurozone crisis. Today, a 60-year-old French citizen can expect to live to roughly 85 and retire at 62. In other words, he or she can look forward to around 23 years outside the workforce, compared with roughly 11 years for their counterpart in the 1970s. As a result, France's old-age dependency ratio has risen from 20% in 1970 to 37% today.

To be fair, the decline in the retirement age between the 1970s and the early 2000s was an international phenomenon, reflecting the rapid expansion of welfare states across advanced economies. Yet France pushed this trend further than most. The OECD average effective retirement age fell from 69 in 1970 to a low of 64 in the early 2000s. Italy, despite carrying a heavy pension burden and having historically been generous with early retirement schemes, has maintained a higher effective retirement age than France since the mid-1980s, with only a brief exception between 1993 and 1995.

More broadly, the challenge is not simply that people (in France as much as in the rest of Europe) now spend an exceptionally long period in retirement given current demographic trends. The challenge is that millions of retirees remain cognitively and physically capable of productive work, yet are effectively sidelined for a large chunk of their life. According to an IMF study, a 70-year-old in 2022 displayed cognitive performance, measured through memory, orientation and mathematical tests, comparable to that of an average 53-year-old in 2000. The same individual also exhibited physical capabilities, including lung function and grip strength, similar to those of a 56-year-old a quarter-century earlier.

Put simply, today's seventy-year-olds are the new mid-fifties. In other words, allowing someone to retire at 62 today (as it is the case in the France) is roughly equivalent, in terms of health and functional capacity, to barely allowing a 50-year-old to retire in 2000. We continue to classify as "old" many people who remain healthy, capable and economically productive, thereby foregoing a significant source of labour, growth and fiscal sustainability.

Ageing vs. longevity

This is an important aspect if we want to approach today's demographic challenge the right way -- and this is especially relevant for today's pension debate in France. Population ageing and longevity are related but are two distinct concepts. Ageing results from the combination of low fertility and rising life expectancy. Longevity, by contrast, refers to the extension of cognitive and physical capacities over the life cycle. While ageing focuses on the chronological age structure of the population, longevity focuses on the biological age of individuals. In other words, people may be getting older on paper without ageing at the same pace in terms of health, productivity and functional capacity.

For the economy, population ageing is largely a negative development. It reduces the size of the workforce, weighs on productivity and increases fiscal pressures through higher pension and healthcare spending. Longevity tells a different story. If people remain healthy, active and productive for longer, societies gain access to a new pool of human capital. What appears to be a demographic burden when viewed through the lens of ageing can become an economic opportunity through the lens of longevity.

And this has enormous economic implications. For more than a century, we have thought of life as a linear sequence: education, work, retirement. This model worked when life expectancy was around 70 years. It is far less suited to a world in which people can expect to live to 90 or even 100, especially at a time of rapid technological change and mounting fiscal constraints.

Longevity requires a transition from a life organised around distinct stages to a more fluid and continuous economic journey. Rather than learning at the beginning of life and relying on those skills for the next forty years, individuals will need to learn, work, reskill and reinvent themselves multiple times over the course of a much longer life.

Moving from managing ageing to promoting longevity would require a profound rethinking of how European welfare states are designed. Such reforms would not dismantle the welfare state; they would adapt it to today's demographic realities rather than those of seven decades ago.

The broader implications

If French politicians started framing longevity as an opportunity rather than portraying pension reform as an assault on acquired rights, they would send a much stronger signal to investors than another round of short-term budgetary manoeuvres would. Markets are increasingly questioning whether France can sustain one of the largest welfare states in the developed world while a shrinking share of the population finances a growing retired cohort. Pension reform addresses the symptom. A longevity agenda addresses the underlying challenge. If framed realistically, it could gain both domestic political consensus and the trust of financial markets in the medium term.

Viewed through this lens, France's demographic transition should not be seen solely as a source of risk. France combines world-class healthcare, a leading life-sciences sector, strong research institutions and a relatively favourable demographic profile compared with much of Europe. If these strengths were mobilised to support longer productive lives, the country could strengthen its growth potential, broaden its tax base and improve the long-term outlook for public finances. Over time, that would matter as much for the trajectory of OAT spreads as any individual budget negotiation.

Achieving this will require not only a redesign of the welfare state, but also a broader change in mindset among citizens, starting with a serious and honest political debate about ageing and longevity. But if Aaron is right, the prospects for such a shift remain limited. Given the current level of political polarisation, it is unlikely that the French National Assembly will deliver any ambitious reforms in the near term.

A watered-down budget will probably be approved in the coming weeks through legislative manoeuvring. And even though this is far from ideal from a moral-hazard perspective, prolonged policy paralysis in France and rising spreads might at some point prompt the ECB to deploy the instruments at its disposal – ranging from verbal intervention and a halt of quantitative tightening to, if necessary, activation of the Transmission Protection Instrument (TPI) or even a return to asset purchases.

Any ECB intervention would only buy time for France. Eventually, investors expect immediate and resolute fiscal measures, namely spending cuts. And as it has been the case for any populist party winning an election across Europe, once in power financial markets force them to moderate. This would be the case for both Mélenchon and Le Pen. Not surprisingly, the latter has already pledged her intention to bring public spending below 50% of GDP by

2032 – with a good chunk of the savings coming from a reduction of the contributions to the EU, while commitments on adjusting pension spending remain vague (to say the least).

At a time when Europe needs deeper integration to navigate an increasingly unstable geopolitical environment, such a nationalist approach would be self-defeating, just as continuing to view older people primarily as a fiscal burden is economically shortsighted. The countries that emerge stronger from the demographic transition will not necessarily be those with the youngest population, but those most capable of turning longer lives into longer productive lives.

Major powers are increasingly beginning to view longevity as a strategic factor. During a meeting in Beijing in 2025, Vladimir Putin and Xi Jinping reportedly discussed how advances in biotechnology could dramatically extend human life, with Xi referring to forecasts of life spans reaching 150 years and Putin stressing the potential of medical progress to prolong healthy and productive years.

That conversation is quite telling. Faced with shrinking workforces and adverse demographic trends, China and Russia increasingly understand that national power depends not only on the size of the population, but also on the number of healthy and productive years it can contribute. In this sense, longevity is more than a social policy objective. It is a strategic and geopolitical asset. This should serve as a lesson not only to France, but to Europe as a whole.

Enjoy your weekend!

Edo

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