Pensions in Germany in Jeopardy (August 15, 2016)

Abstract

The combined consequences of an ageing population and low birth rates place a burden on the financing of the pension system. An increase in the retirement age is unpopular but may be unavoidable. The author recommends linking the retirement age to life expectancy, as is practiced in some European countries.

Source

Pensions in Germany under tremendous pressure

Conditions for future German pensioners will worsen. An increase in the age of retirement to 69 is unavoidable. In addition, Berlin must finally update the projections of the Bundesbank [Federal Bank].

There are problems which do not have a painless solution. They include securing pensions. Over the long term, Germany is heading for a major problem when it comes to providing for old age. The pay-as-you-go pension scheme in Germany is encountering its limits because of demographic changes, that is, rising life expectancy and the simultaneous decline in the birth rate.

The changing governments are putting off the solution to the problem, because for now they can still afford to do so. Moreover, important forward calculations end at the critical limit in 2030. The Deutsche Bundesbank has now put its finger on this sore spot with its monthly report due out on Monday.

Too short a projection time scale

The experts at the Frankfurt institution point out that the German pension scheme is under tremendous pressure. They maintain that unpleasant changes to one of the three important parameters for old-age provision are unavoidable in the coming years. The statutory pension scheme is heading for major problems, especially from 2030 on.

In principle, there are three adjustment screws that one could turn when it comes to old-age provision: first, the contribution rate that current employees have to pay; second, the retirement age; and third, the benefit level for current pensioners. Beyond that there are additional options, such as expanding the federal subsidy for pensions or bringing the self-employed into the system, but these are not sufficient to solve the basic problem.

Problems are being put off into the future

According to the current plans, the retirement age is to increase to 67 by 2030, the contribution rate is not to rise above 22 % (currently 18.7 %), and the benefit level is not to fall below 43 % (47.7 %). Many of the present forward-looking calculations up to 2030 are based on the year 1989 and at the time they encompassed a period of 50 years. However, since then the new calculations were never expanded beyond 2030, which means that the projection period is by now merely fourteen years.

With that, politicians are shirking away from acknowledging important information and creating transparency, since the demographic problem will worsen after 2030, when the baby boomer generation reaches retirement age.

People are living longer and longer

The percentage of the period during which a pension is drawn compared to the period during which contributions are paid is constantly expanding. From the current level of about 43 % it would rise to around 53 % in 2060, if the retirement age were to remain at 65. That percentage could be maintained if the starting age for retirement were to rise to 67 by 2030, and 69 by 2060.

However, that would not be sufficient yet to stabilize pensions. In addition, one would have to reckon with another substantial increase in the contribution rate from the current level of 18.7 % to about 24 %, which would presumably have a significant impact on economic growth and would amount to a decline in the benefit level from presently 48 % to about 44 %.

Indexing of retirement age

Things could also be better with private retirement provision in Germany, especially with respect to simplification and greater transparency. Currently there are about 16.5 million so-called Riester accounts, by means of which the state is promoting private provision, for example through unit-linked life insurance, with 40 million individuals entitled to this support.

However, in Germany there are different paths to private provision: many people own real estate, and around 60 % will eventually receive work-based pensions.

Still, the Bundesbank believes that further adjustments are inevitable to secure the financial sustainability of pensions. Along the way, a longer working life – for example, to 67 beginning in 2030, and to 69 from 2060 on – is virtually unavoidable.

Countries like Denmark, Estonia, or Italy have linked the retirement age to life expectancy. This could also be one way for Germany to make the politically difficult decision automatic and thus easier.

Source: Michael Rasch, "Rente in Deutschland massiv unter Druck," *Neue Zürcher Zeitung*, 15 August 2016.

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