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(English version)

The German pension system: Better than its reputation

by Michael Heise

In the year before an election, it is not surprising to hear politicians talk about pension increases. What is remarkable is that, even in the political center ground, proposals are being bandied around that aim to unravel key elements of the pension reforms of the last two decades. The move towards a supplementary fully-funded pillar is being questioned. The state-sponsored Riester pension, so the argument goes, has not caught on widely enough to compensate for the gradual reduction in statutory pension entitlements. More and more pensioners would become dependent on welfare benefits. Therefore, the statutory pension must be raised again, not only for low-wage earners but for everybody.

Of course, any sustainable pension system has to be adjusted to changing economic and social conditions. But the current pension debate is based partly on half-truths, scare-mongering and political calculation. In Germany's rapidly aging society, the issue of retirement provision is too important to be left to political maneuvering.

Critics assert that almost half of Germany's retirees already face poverty because their monthly pension payout amounts to less than EUR 750. Those numbers are misleading, however. Most of these paltry pensions belong to women who have accumulated limited entitlements while bringing up children and working as home-makers rather than in paid jobs. But as a rule, these women tend to live with a partner who also draws on a (usually bigger) pension.

Moreover, the statutory pension accounts for only 64% of the average retirement income. Add income from occupational pensions, life insurance policies and rents and the picture looks quite different. According to the Federal Statistical Office, the average pensioner household has net income of EUR 2,460 a month, compared with EUR 3,150 for all households. These figures go a long way to explaining why only 3% of German retirees have applied for welfare benefits to top up their pension to the basic income level. The assertion – currently being made by politicians and others – that Germany's system of pensions and benefits creates mass poverty is simply unfounded.

It is true that the growing number of part-time (or mini-) jobs will impact on tomorrow's pension entitlements and force more people to rely on welfare payments when they retire. The solution, however, cannot be to outlaw such forms of employment, as is now often suggested. In a market economy, supply and demand determine the nature of jobs. Today's part-time or temporary jobs will not suddenly be converted into full-time employment if the law changes.

If Germany rolled back the labor market liberalization of the Schröder era, unemployment would soar again. It is no coincidence that France, with its rigid labor market, has an unemployment rate twice as high as Germany. Those who lost their jobs in the wake of such a reform would then acquire pension entitlements solely via unemployment insurance. Nor should it be forgotten that among the 6.7 million mini-jobbers in Germany, there are some 1.6 million people over 60 who are topping up their retirement income.

It is also true that since around the year 2000 wage growth in Germany has been subdued, and a sizeable low-wage segment has emerged in the labor market. These moderate wage increases were to a large degree the correction of previous excesses, and they played a pivotal role in reducing unemployment from its 2005 peak of over 5 million. A policy U-turn that aims to push up wages without boosting underlying productivity might put these achievements at risk.

The government can, nevertheless, do a number of things to defuse the impact of low wages on pensions. One would be to reduce the overall tax burden, which is high even for low incomes. TV debates about the looming pension crisis regularly feature an unmarried sales assistant or cleaner who takes home just EUR 1,400 a month and is simply too financially stretched to set anything aside for retirement. What is never mentioned is that she has already handed over EUR 700 in taxes and social security contributions to the state. Gerhard Schröder once reminded people that well-intentioned improvements in social policy – such as early retirement provisions and top-up pensions for mothers and others who did not earn enough to accumulate sufficient entitlements – have to be financed by higher contributions from middle and low-wage earners, too. The tax burden on low incomes is too high as it is. It should be reduced, for example through raising the income tax threshold or introducing a negative income tax for low-wage earners.

Some policymakers advocate transferring the full bill for higher pay-as-you-go pensions to employers. Like that, they argue, take-home pay stays the same and pensions can still rise. But they ignore the impact on jobs. The number of jobs a company creates does not depend on how its costs divide into wages and payroll taxes. If government policy pushes up the overall wage bill, companies that operate in competitive markets may be forced to cut their headcount. Job cuts help neither the retirement prospects of the employees affected nor the sustainability of the social insurance system. Our memories of Germany's bleak labor market situation 15 years ago should still be fresh enough to prevent such mistakes.

Then there are those who want to salvage the pay-as-you-go system by making everybody contribute, including civil servants and the self-employed who are currently exempt. A broader base of contributors would quickly add billions in pension contributions – while the new contributors would start making claims on the system only in years to come. For the long-term sustainability of the system, however, such a move is not the solution. On the contrary: plentiful revenue in the early years is unlikely to be used to create reserves for the future. More likely, it will create new, more generous entitlements – which are notoriously hard to cut subsequently.

The main argument deployed by those who are calling for a return to a higher pay-as-you-go pension is that with record-low interest rates fully-funded pensions cannot adequately compensate for gradually declining public pension entitlements. True, returns on retirement savings have fallen sharply in the wake of sliding interest rates and negative central bank rates. This is especially true for Riester pensions which, in line with legal requirements, must guarantee paid-in capital and provide a life-long annuity. But by no means do low interest rates render saving for retirement superfluous; on the contrary, they make it more important. Those politicians who are now talking down Riester pension plans risk harming primarily those low-income earners who stand to gain most from Riester thanks to the generous public subsidies for married couples and children.

This brings us to the truth at the heart of the current pension debate: low interest rates do necessitate adjustments in the pension system. First, the framework for company pensions must be improved significantly. For example, the government might want to introduce allowances for lower wage earners (similar to those for Riester), since the latter gain little from the tax advantages in the present system. Second, supportive measures are needed for low-paid self-employed workers and those without a continuous employment record. One straightforward step would be to reduce the amount of company and private pension benefits

that are deducted from welfare payments, thus leaving an incentive to set money aside for old-age. Individual efforts to save for retirement need to be rewarded.

It is to be hoped that the pension debate shifts away from well-intentioned but ultimately counterproductive proposals and looks at the genuine need for reform. Many of the proposals currently on the table undermine the fundamental pillars of the labor market and pension reforms that helped to pull Germany out of the deep employment and debt crisis at the start of the last decade – and which are now being copied in a host of other European countries.

The basic insights underlying the pension reforms of the last two decades remain true: the inevitable rise in the number of elderly Germans, coupled with a decline in the working-age population, requires adjustments in the pension level. Otherwise, workers and companies face steep rises in pay-as-you-go contributions, which would endanger purchasing power and jobs. Today, these insights frequently seem to be forgotten – and that although the facts are clear. Just look at the number of those leaving the labor market compared to those entering. In just five years' time, the number of the former (those aged 60-69 years) will be 1.25 million higher and the number of the latter (15-24 years) around 400,000 lower than in 2015. And this trend is set to intensify in the years thereafter, even in scenarios with high immigration.

Pension and labor market policies that are guided solely by Germany's currently bright economic situation while ignoring the looming demographic burdens would soon undermine both jobs and investment. Germany could swiftly become Europe's laggard again, just as it was 15 years ago.

Link to German original:

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