

**LETTLAND**

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# Fairness in the welfare system

## INTRODUCTION

The concept of fairness is open to interpretation. On the one hand it is a matter of subjective perception. Children find parents unfair, and *vice versa*, and the defendant or the plaintiff will find a court judgment unfair. Sometimes voters find politicians unfair too, or a politician finds the verdict of the electorate unfair. We shall not be able to establish today what is truly fair. All we can do, in fact, is to make the concept of fairness manageable. We can achieve that if we set criteria for assessing fairness.

The policy of a social market economy sets the regulatory framework, thereby enabling people to succeed through hard work and achievement. It thus creates the opposite of a static society in which the state sees its role primarily as a collector, distributor and maintainer. If we believe the opinion polls, such a policy also reflects the predominant perception of fairness within society, in which equality of opportunity, fairness between generations and fair reward for effort take precedence over fair distribution of wealth (Allensbach study, 2013).

The crucial point is that everyone should be given the opportunity to take part in this dynamic process. Education is possibly the most indomitable bastion of privilege when considered over many generations. As the CDU stated in the keynote motion for its party congress in 2012, *"We want a society based on true equality of opportunity. Germany is very much a country of opportunity. Everyone here should have the chance to succeed and to strive for personal fulfilment. People's destiny must not depend on their roots. For this reason we want a republic built on education, in which all people have good opportunities that match their abilities and inclinations and hence scope*

*for personal development and social mobility."*

Today I should like to deal with the link between social-security systems and fairness. In so doing, I intend to focus on the three main branches of the welfare system, namely pensions insurance, health insurance and unemployment insurance. Care insurance is largely based on the principles of health insurance, and accident insurance is something of an exception, in the sense that employers alone pay the premiums. Remarkably, although the three welfare schemes under examination are all funded more or less equally by employers and employees, they are based on diverse principles.

Pensions insurance is based on the equivalence principle. This means that higher contributions create higher subsequent pension rights. The contribution rate is governed by the contributor's income, because the subsequent pension is intended not only to ensure his or her subsistence but also to guarantee the maintenance of a similar standard of living. There is a wide consensus in favour of the principle of commensurate reward in Germany; it may be said that the system is considered fair.

The statutory health-insurance scheme requires income-based contributions from its members, and all contributors, whether they are among the lowest earners or whether their income exceeds the threshold from which the maximum contribution is payable, receive the same benefits if they fall ill. Some ten years ago, fruitless attempts were made, with some support from within the CDU and CSU, to switch to a standard contribution rate. This would have made health insurance more expensive for low earners and cheaper for high earners.

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The current model, however, with its unquestionable redistribution element, receives very broad backing. Once again, we could say that it is felt to be fair.

Conclusion:

Both approaches, though based on divergent principles, are vigorously supported, as a rule, by the same protagonists. This surely means quite clearly that tradition trumps principle. It also demonstrates that I would be ill advised to go beyond a mere expression of opinion or observation and presume to make a valid judgement as to which approach might be considered fair outside Germany. A lack of detailed knowledge of traditions and current circumstances would suffice to undermine such an assessment.

**HEALTH INSURANCE**

Now one might ask whether it is fair that only remuneration for work is used to assess the rate of contribution to health insurance and that earnings such as income from rent and capital gains are excluded. Another issue is the system of private health insurance that exists alongside the statutory scheme. This dualism has its roots in the constitutional question whether anyone who has the wherewithal to cover his or her own risks can be forced into a welfare system. We are familiar with the debate in the United States, where large sections of the middle classes regard compulsory health insurance as Socialism.

Unlike fifty or so years ago, given the blistering pace of medical progress and the emergence of promising but sometimes extremely expensive treatments, even today's top earners would find it impossible, in most cases, to foot the bill from their bank account or safe deposit box, and so they often have recourse to a private health insurer. These insurers levy premiums which, in contrast to contributions, are not determined by income but by actuarial risk calculations in each individual case, based on factors such as the policyholder's age, medical history and, until recently, sex. Another cornerstone of private health insurance is the civil service. One of the funda-

mental principles of the law governing the civil service is that public authorities contribute significantly to the provision of insurance cover against life's major risks for the civil servants in their employment. Accordingly, they pay a grant towards their civil servants' private insurance premiums but not towards contributions to the statutory health scheme.

We hear frequent complaints that privately insured patients obtain doctors' appointments more quickly and receive better treatment, sometimes new treatments which are not funded the statutory health scheme until some time after their introduction. These benefits are reflected in the premium, and so they are covered. In addition, the statutory health scheme is cross-subsidised through the system of public health, in that providers of services to private patients often receive higher payments. This incentive is not always advantageous for private patients, because it can encourage service providers to conduct tests on them that are not strictly necessary. It certainly does create scope, however, for the rigid cost-cutting policy in the statutory health-insurance system. And even though contributors to the statutory scheme receive an excellent standard treatment package in Germany, allegations of unfair treatment are never far from the surface. It may be said that dualism is considered by the great majority to be unfair.

Conclusion:

For various reasons, merging the two systems in Germany would pose huge problems. Where there is still any scope to opt for a particular system, a clearly structured system should be given preference over a tiered system, e.g. statutory basic care and private additional care.

**PENSIONS INSURANCE**

I have referred to the perception that the system of pensions insurance is organised fairly. In actual fact, only about three per cent of today's pensions in Germany are below subsistence level. Nevertheless, a number of fairness issues arise in connection with pensions insurance.

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The real question is how the system can be adapted to demographic trends, in other words how fairness between generations can be achieved. In 1956, when the federal cabinet was discussing the shape of the pensions scheme, Economics Minister Ludwig Erhard, the father of the social market economy, argued for a switch to a funded system. Future generations, he said, should no longer meet the cost of their parents' pensions under an intergenerational social contract. Contributions to the pensions scheme, like insurance premiums, should be invested in capital markets.

Federal Chancellor Konrad Adenauer responded by saying that people would always bear children. He had his way, and the cabinet voted in favour of the intergenerational pact and the automatic index-linking of pensions to reflect wage and price trends. At the risk of perhaps alienating the Foundation dedicated to his memory, I have to say that he was wrong, at least in so far as the invention of the pill shortly afterwards led to a sustained decline in the birth rate, which weakened the foundations of the social contract between the generations. The 1980s saw the emergence of a debate on the adoption of a new system, but German reunification made this totally unrealistic, and the debate became distinctly muted.

All subsequent forecasts indicated that pension levels would have to fall significantly. We now know that there will be more than a few cases in which pensions will be below or only barely above the subsistence level. In the case of low-income groups, this may even happen to people with lifelong contribution records. The Federal Minister of Labour found that this infringed the principle of commensurate reward and wanted to ensure that pensions remained above the basic subsistence level by means of a mathematical adjustment to the value of the points that determine pension expectancy rights. This problem is fundamental, for if future expectancy rights are evened out around the subsistence level, the legitimacy of a system based on pay and contributions will be jeopardised.

Even the so-called Riestler pension, the heavily subsidised supplementary funded pillar of the pension system that was introduced by the SPD-Green coalition government, has plainly failed to save the day. The Riestler pension was supposed to go a long way towards closing the demographic gap. However, it is not compulsory, and the very group of people for whom it would have been a particularly useful safety net have too often chosen not to participate, even though low earners with minimal contributions could claim substantial state assistance. Nor has the Riestler pension lived up to expectations in terms of returns, given the uncertainties in the capital markets and the current low interest rates. Returns are barely any higher than the invested tax revenue.

This suggests that Adenauer might not have been so wrong after all in opting for the intergenerational model. It is a sobering thought that even more money might otherwise have been exposed to the vagaries of capital markets for the purpose of guaranteeing the amount needed to fund pensions for present and future generations.

The other question is how the statutory pensions scheme is to be put on a sound financial basis for the future. We are all familiar with the adjustable parameters, namely the contribution rate, expectancy rights and the retirement age. The Grand Coalition of the CDU/CSU and the SPD implemented a gradual raising of the retirement age from 65 to 67. That has proved very unpopular, and even from within the SPD, which played a major part in the drive to raise the retirement age, we are now hearing calls for the process to be halted. In the political arena, it is easier to win support for arrangements that make future generations carry the can.

This is demonstrated by the sum of 80 billion euros that is already being fed into the pensions system from the federal budget today, long before the shock waves of demographic change have been fully experienced. This same thread, incidentally, runs through the topics on today's agenda. Although the federal subsidy also encom-

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passes non-insured benefits for which the pensions-insurance fund has to foot the bill, if it did not exist we should certainly have been able to balance the budget in past years largely without incurring debts as well as having more money to spend on education, etc., and leaving fewer burdens for future generations to carry. We are looking at a total amount of one trillion – 1,000 billion – euros. Is this fairness between generations?

That, unfortunately, is how things are. Future problems are initially an abstract concept, and those whom they might affect pay little heed to them. They certainly do not join forces to exert political pressure. On the contrary, some of the present generation of pensioners even tend to project the future problems, which will not affect them, onto their present situation, which is generally comfortable. It does not take a crystal ball to predict that the meagre pension increase of 0.2% in western Germany which takes effect on 1 July 2013 will influence the parliamentary elections more strongly than the concerns of younger generations about the burdens that await them and about the prospect of inadequate pension cover.

Conclusion:

The combination of the diverse variants with the focus on a statutory pension plus a supplementary funded benefit and an occupational pension seems to be a logical proposition, whatever its defects. It is highly questionable, however, whether it is possible or right to establish a statutory pension that guarantees more than basic subsistence in the absence of an ideally shaped age pyramid. Such attempts might well raise unfulfillable expectations.

**UNEMPLOYMENT INSURANCE**

In the realm of unemployment insurance, benefits were cut drastically by the reforms implemented by the SPD-Green coalition government under Gerhard Schröder in the wake of the Hartz report. These reforms included a reduction of the eligibility period for unemployment benefit from the insurance fund. Workers with a lengthy employment and contribution record find it particu-

larly unfair that, after a year out of work, they should be lumped together with recipients of social assistance. The main aim was to create incentives for people to seek employment. A catalogue of activating measures was established as a counterweight to 'passive' benefits.

At the same time, standard benefits were cut to increase the pressure on former recipients of social assistance, who now receive basic jobseekers' allowance, to find work. Experts take the view that the present rates are not sufficient to guarantee sustained economic and social subsistence. Advocates of the system argue that the benefits are simply not designed as a long-term source of income. The integrative measures, they say, have been stepped up, as a result of which the adoption of the new system has led to more public expenditure rather than savings.

This approach is cited as one of the reasons for the upturn in the German job market that has seen unemployment fall from five million to three million. When two million people left the dole queue, a step was clearly taken towards equality of opportunity, but was it perhaps taken at the expense of fair distribution for those who remained on benefit?

Adverse side-effects are certainly observable. The increased pressure within the job market, particularly for low-skilled jobs, has pushed down wage levels for existing employees, as has emerged from analyses conducted by bodies such as the Federal Employment Agency's Institute for Employment Research. In connection with a 'low-pay sector' policy, even many skilled employees have been helpless victims of downward pressure on pay levels. The nefarious knock-on effect of this policy is reflected in the fact that 81% of low earners today have completed vocational training or a university degree. Half of them do jobs that match their qualifications. The income distribution curve for the past fifteen years also mirrors this trend.

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Conclusion:

Incentives for people to seek work is less of an issue in countries with a less developed system of social security. In general terms, however, it is important to undertake a systematic examination of all proposed adjustments with a view to identifying their potential implications.

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