The Price of Social Security or Social Security at all Costs?

Current Trends in Pension Provision – The Case of Germany

Tokyo March 24
Agenda

1. German Situation: Facts and Figures
2. Reforms since 2000
3. Evaluation of the Reforms
1. Elderly Population as a percentage of total population (OECD)
1. Total fertility rates (OECD)
1. Life Expectancy

Life Expectancy Germany 1960-2010

- Blue line: Men
- Red line: Women
The key-characteristics of the German pension system

◆ Dominated by a statutory pension insurance

◆ Pay as you go (ongoing payments of the employees are directly used for the benefits of the retirees)

◆ Demographic change will cause the system to the limits of affordability
1. Germany – Facts and Figures

Elderly Dependency Rate Germany

Source: Federal Statistical Office 2013
2. Reforms since 2000

- Objective: Balance the pension budget
  - Increasing the contribution rates
  - Lowering the pension payments per capita
  - Mixed Strategies
2. Reforms since 2000

Reform in 2001:

- Lowering the pension level by the adjustment of the pension on the modified net wage level

- Introduction of an additional funded pension (promoting supplementary private pension contracts “Riester-Rente”)
2. Reforms since 2000

Reform in 2004:

- Pension adjustment based on the development of the elderly dependency rate in order to limit the contribution rate on maximal 22 per cent
2. Reforms since 2000

Reform in 2007:

- Gradual increase in the retirement age from 65 to 67 from 2012 to 2029.

Reform in 2009:

- Pension protection clause: wage reductions do not lead to pension cuts
2. Reforms since 2000

Reform in 2014 (planned):

- Employees who have contributed to the pension insurance for at least for 45 years will be able already to retire at the age of 63.

- Higher pensions for mothers whose children were borne before 1992 (at the average 27 Euro per child per month)
3. Evaluation of the reforms

- Stop and go policy
- Problems of inconsistency
- Dominated by redistributitional aspects between contributors and pensioners
- However, all this reforms cannot solve the fundamental problems of an aging society
- Especially the current planned reform in 2014 is a backward step
Most important step was the increase of the retirement age from 65 to 67 years in 2007

- Average increase of the life expectancy of 2.6 months per year

- Average increase of the retirement age from 2012-2029 amounts 1.3 months per year

- Increase of the working life by a half and the pension time by a half
3. Evaluation of the reforms

- The introduction of the funded pension in 2001 penalizes the generation who must financed the transition from the PAYG to the funded schemes

- Generation has to pay twice

- Growing importance of the tax founded grants of pensions

- Tax financed pension reduces performance incentives and distorts allocative efficiency
3. Evaluation of the reforms

**Share of the tax financed subsidies**

- **1970**: 15%
- **1975**: 15%
- **1980**: 20%
- **1985**: 20%
- **1990**: 15%
- **1995**: 25%
- **2000**: 30%
- **2005**: 35%
- **2010**: 35%

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3. Evaluation of the reforms

Reform of 2014

- Pension with 63 destroyed the previous success
- Redistribution from young to old
- Bad signal
- Explained by public choice theory
- Higher pensions for mothers lead only to intra-family redistribution

High costs and low benefits
3. Evaluation of the reforms

- Not aging is the problem, but the low birth rates are the problem

- Reform policy should be embedded in:
  - Family policy
  - Education Policy
  - Labor Market Policy