The German government's pension package

After the reform is before the reform

Dr. Michael Heise on Global Economics

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After months of work, the German government has presented its "pension package II". There were no major surprises. It essentially consists of two elements that were already agreed in the 2021 coalition agreement. It is therefore also clear that, despite the innovations, contribution rates are expected to rise due to the relative increase in the pension level after 2025.

The first element of the pension package is the so-called "stop line" for pensions. It involves a minimum pension level of 48%, which is to be guaranteed not only until 2025, but also beyond. The sustainability factor, which should also adjust the pension level to the shifting ratio of working people to pensioners - and thus bring about a balance between young and old - is undermined.

The generation capital should be welcomed

The second element of the reform, the "generation capital", is new and, as the authors rightly say, represents a paradigm shift. A capital stock is to be gradually built up with the help of public loans or asset transfers, which is intended to mitigate the expected increase in contribution rates to the statutory pension insurance scheme from 2035.

The concept is based on the assumption, which is certainly correct, that the return on a broadly diversified international equity investment will be significantly higher than the federal government's interest on debt in the long term. Although this is a collective capital stock, i.e. not individual claims of the insured persons, the community of insured persons nevertheless participates in the returns of the capital market.

allows the community of insured persons to participate in the returns of the global capital markets and adds a third pillar to the financing of public pensions. In addition to contribution income and a sharp long-term increase in federal subsidies for pension insurance, the (net) income from the generational capital is now also being added.

Even with the planned dynamization of federal funds in ten years' time, the size of this capital stock will certainly not be large enough to have a strong effect on contribution rates. But it is a very important first step in a pension system that relies far less on capital market participation than is the case in most other developed economies. The USA, Switzerland and Sweden are particularly clear examples of the opposite.

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Despite the generation capital, the resolutions will result in rising contribution rates and federal subsidies after 2025

Even due to the envisaged timelines, the considerable additional expenditure that will be generated by the pension level holding line at the end of this decade cannot be compensated for by the generation capital. Employees must be prepared for significantly higher contribution rates up to 2035. The federal budget will have to make significantly higher payments to the pension insurance scheme, despite all the funding deficit in other areas. The strong expansion of the welfare state will continue.

It is fairly certain that further reforms to statutory pension insurance will have to be tackled in the coming years in order to put the financing of pension insurance on a solid footing. A debate on early retirement without deductions and linking pension increases to rising life expectancy is likely to play an important role here. These hot potatoes have not been addressed in the current pension package. There is probably also no possible consensus on this in the coalition government.

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