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Research Report

On the Path to Old-Age Poverty - Assessing the Impact of the Funded Riester Pension

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Report

At a glance

- The pension reforms of 2001 and 2004, with their deprioritising of living standard security, gradual reduction of the pension level and simultaneous introduction of the optional Riester pension prove problematic: Increasing old-age poverty is forseeable.
- The partial transition from the statutory pay-as-you-go pension system to the funded Riester pension system does not fulfil its promise. Many people either do not have a Riester contract or make very low contributions. The financial market and euro crises have reduced the rates of return, while it is clear that the funded system cannot limit the demographic risks to security in old-age.
- Politicians have to act. The statutory pension level must not be lowered any further, and should instead be increased to the OECD average. Instead of subsidising Riester contracts, government funds should be used fo a targeted increase of low pensions while re-establishing an acceptable disability pension.

On the Path to Old-Age Poverty

Assessing the Impact of the Funded Riester Pension

Heike Joebges[1]/ Volker Meinhardt[2]/ Katja Rietzler/ Rudolf Zwiener

Table of contents

Problematic Pension Reforms 1
Risks of a Funded Pension System 2
Investments abroad are no Solution 4
Is the Riester Pension worth it? 6
Macroeconomic Effects of the Pension Reforms 10
Pension Gaps and Impending Old-Age Poverty 12
The Wrong Path 15

Problematic Pension Reforms[3]

The pension reforms of 2001 and 2004 have initiated a fundamental shift in the objectives of the statutory pension system: from the securing of living standards in retirement to stability of the contribution rate. Concretely, the contribution rate should rise up to a maximum of 22% in 2030. Without the reform measures the contribution rate would in contrast rise up to around 26% in the year 2030 (Dedring et al. 2010). Hence, factoring in projected demographic developments, the pension level will gradually drop (see Infobox 1). Additional measures, which are not considered in the indicator pension level, further reduce pension payments: training periods are generally no longer accredited;

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[3] This publication is based in parts on the essay „Kapitaldeckung in der Krise“ (Joebges et al. 2012).

times of unemployment are rated lower; and there will be reductions in pension benefits in the case of early retirement. All this leads to the statutory pension system contributing a considerably lower share towards a living standard-securing old-age income.

To counteract the strong reduction in the state pension level, employees should plan on supplementing it either through company pension schemes and/or privately without employer participation through the framework of the newly-introduced Riester pension, which is supported by government grants and tax breaks depending on family status and income. In addition, both private and company pension schemes are still supported through tax-deductibility and exemption from taxation and social insurance on the deferred compensation.[4]

The economic and socio-political objectives of these reforms were to reduce the costs of the statutory pension system against the backdrop of demographic changes, and to lower the non-wage labour costs in order to increase international competitiveness as well as growth and employment. At the same time, financial security in old-age was to be ensured via the introduction of the funded Riester pension. With the partial transition from a pay-as-you-go to a funded system, it was hoped that higher returns would be realised than with only pay-as-you-go, in line with international views on the topic (see World Bank 1994 and the later critique by Orszag and Stiglitz 1999).

Meanwhile, however, it is questionable whether these aims will be achieved. Initial follow-up studies of the pension reforms and especially of the Riester pension show that many promises are far from being kept. In the following we will show that the combining of a funded pension with the statutory pension is in no way suitable for securing life standards in old-age. If the reforms stay operative, as it stands, considerable parts of the working population will slip into old-age poverty.

Risks of a Funded Pension System

Instable financial markets

For the quality of social security systems, and especially pension systems , the stability and predictability of future benefits is a crucial criterion. If an employee saves up for his or her retirement or contributes to a pension scheme during their employment phase, he or she must be able to appraise over an extended period how much he or she needs to save up or contribute in order to receive a desired level of benefits. Research on private funded pensions in the USA shows that returns tend to fluctuate

INFOBOX 1

Standard Pensioner and different Pension Levels

The *pension level* indicates the proportion between a *standard pension* and the average income of all people in paid work in the same year. The standard pension underlying the calculation corresponds to a deduction-free old-age pension after 45 years in each of which the average has been earned. But most pensioners never reach this high number of contribution years. The standard pension is an 'artificial pension' in that it does not correspond with the average pension. The pension level can be calculated as a *gross pension level* or as a *net pension level*.

With the Pension Insurance Sustainability Act (2004) the calculation of the pension level had to be adapted to gradual changes due to deferred taxation. The new pension level indicates the relation between wages and pensions without taking into consideration the corresponding impact of taxation in each case (pension level before taxation). For the net pension level the relevant social insurance contributions incurred – both on wages and pensions – are subtracted. But the *pre-tax pension level*, which presently serves as the official definition for the pension level, is skewed upwards because it assumes that all employees are paying into private pension schemes and therefore the net wage is reduced.

The *net pension level before taxation* currently stands at 50.4 %. According to official estimations, it will decrease to 46.2 % by the year 2025, but it should not fall below 46 % before 2020 and not lower than 43 % by 2030. In contrast, for its international comparisons the OECD calculates so-called *gross replacement rates* and *net replacement rates*, which in principal correspond to the gross and net pension levels formerly used in Germany. For each country the national "standard working life" is taken as being from age 20 up to the statutory retirement age under present and future statutory pension conditions.

The OECD figures show a gross replacement rate of 42 % for an average German employee. The average rate for 34 OECD countries is 57.3 %. Therefore, in comparison with the other countries, Germany ranks in the lower third. The net replacement rate for Germany is 57.9 % (for an average employee), while the comparative average for other countries is 68.6 % (OECD 2011).

considerably in the long term (Burtless 2000). For different cohorts of pensioners with the same level of savings activity, strongly diverging benefit entitlements result. The break-down of the stock-market in 2000/2001 already led to private pension funds registering high losses. The face value of entitlements which had been calculated began to shrink strongly.

Over the course of the latest financial crisis, it has become particularly clear that funded forms of pensions are not stable in times of financial crises. Instead, the pay-as-you-go system has weathered the financial crisis considerably better than the funded pension system (Lenze 2011). According to the OECD, the losses in funded pension schemes in the year 2008 amounted to 23 % on average. Indeed, this high value was due most notably to the losses of US-American pension funds which recorded average losses of 26 % (OECD 2009, p. 25). However, Germany's funded system was also affected, even though the losses were less than 10 %. According to the OECD, the German losses were lower due to stricter regulations: The holding of riskier financial assets – such as shares – is more restricted, and therefore, with the proportion of bonds on the balance sheet being higher, the losses were contained (OECD 2009, p. 33).

Indeed the high losses recorded in 2008 have been partially recovered in the following years through rising share prices. In view of the euro-crisis, the resulting loss in value of government bonds of the peripheral countries will cause problems for funded pension systems in Europe. Pension funds have, for example, been affected by capital losses due to the restructuring of Greek state securities.

These two examples show that an intensified use of the funded system produces systemic risks associated with an increased necessity to accumulate financial assets. The latter are financial entitlement claims which are set against financial liabilities. Such a structuring of entitlements and liabilities involves considerable risks to stability because, if nothing else, panic reactions and herd instinct on the financial markets repeatedly lead to debt crises and thus endanger the security of pension benefits.

Due to fluctuations and crises on the financial markets, a long-term and reliable appraisal of expected future benefits in the funded system is sim-

INFOBOX 2

Pay-as-you-go versus funded systems

'Funded' describes a system of financing pensions which builds assets for individual people (or groups or cohorts) in order to cover the pensions of exactly these people (or groups or cohorts). In contrast, the pay-as-you-go system finances the expenses directly from the payments of current contributions: With their contributions, the currently active earners finance the current pensions. A low capital stock is held only as a reserve fund in case of irregular income flows.

In Germany, the old-age security system is dominated by the statutory pension system with its pay-as-you-go method and no opt-out for employees. This means that the pension contributions from active earners pay the current beneficiaries of public pensions. The German pay-as-you-go system shows a strong correlation between the income-related contribution and the resulting pension. This correlation means that lower incomes and contributions result in lower pensions, and higher incomes and contributions result in higher pensions. The redistribution effects are relatively low and mostly affect pensions received due to a reduction in earning capacity and provisions for dependants. At the same time, the statutory pension system is burdened with additional, so-called 'extraneous insurance benefits' such as the cost of the German reunion, which are generally recovered through a federal grant. Additionally, the Riester pension offers an optional, individual and funded supplementary plan.

A possible redistribution of income, thus incorporating a social dimension, is essentially independent of the type of financing – a pay-as-you-go or funded system. The options through which a social redistribution could be realised are mostly related to the criteria put on the awarding of benefits, and in which respects the contributions are income-related. But a considerable social redistribution through the pension system does imply universal, mandatory participation.

With respect to old-age security, the reduction in earned income in old-age affects everybody. Therefore, it makes sense to design a collective cross-generational system. Should the pension system seek to achieve redistributive effects, one possibility is to reduce the close equivalence between income and benefit, for example by a higher weighting of lower incomes in the benefit-allocation systems. For instance, the pension formula of the US-American pension system, for example, envisages a replacement ratio of 90 % in the lower income bracket. This rate decreases in two steps to 32 % and then 15 % for the upper income brackets (Meinhardt 2011, pp. 10ff).

ply not possible. The possibility of maybe being part of the cohort which profits from of a financial upturn cannot compensate for the risk of maybe being a part of the cohort whose entitlements are strongly reduced. This insecurity can be moderated considerably in the pay-as-you-go system through a long-term effective relation between the income of the working generation and the expected benefits.

Funded systems do not limit demographic risks

A basic justification for the pension reforms of 2001 and 2004 was the burden of contributions to be expected because of demographic developments. Inevitably, an ageing society such as Germany´s will have to use an ever-increasing proportion of its national income for the pensioner generation, who are increasing in number, while maintaining the pension entitlements for these seniors. This can occur through a higher future share of capital gains in the pensioners' income. However, in order to achieve this, the present working generation has to simultaneously build up an individual financial capital stock through consumption-restraint and additional savings, while also financing the present pensioner generation in the pay-as-you-go system. Insofar as a (considerably) higher rate of economic growth is not to be expected – as domestic demand stays low due to consumption-restraint – in a funded versus a pay-as-you-go system it is therefore not justified that the working generation should be burdened twice during the phase of (partial) transition (Davis and Hu 2004). A partial transition to the financing of social security by capital accumulation will more probably lead to growth losses (Meinhardt et al. 1999).

The discussion around the funded system versus the pay-as-you-go system (see also Infobox 2) is often held as if it were possible to put aside tomorrow‘s consumption today with the funded system. But this is not possible. Funded systems and pay-as-you-go systems are rather two alternative means of transferring claims on production into the future (Barr 2000). In the first case, financial assets are acquired whose value including interest should finance consumption during retirement. In the second case, the state guarantees that the consumption of the pensioner generation will be financed by the contributions of the working generation. In each case, however, payments to pensioners can only be paid out of the national income generated in a given year (Mackenroth 1952). Of course, in an open economy the funded system can also claim to incorporate returns based on foreign production as well. However the related risks are considerable. They are reviewed in detail in the following chapter.

Investments Abroad are no Solution

No systematically higher returns

It is often assumed that Germany and other industrial nations could alleviate financing problems for old-age security through the expansion of a funded pension system, and particularly one including investment of the capital in emerging economies. Leaving aside the assumption that the returns in a funded system are higher than in the pay-as-you-go system, it is also assumed that financial investments in emerging economies lead to higher returns and thereby higher pensions (see World Bank 1994). Thus, for example, Döring et al. (2007) recommend a supplementing of the pay-as-you-go system with a funded system based on an evaluation of international studies that had all been conducted before the financial crisis. In order to achieve high returns via financial activity, the funded system should not only use possibilities for diversification but also investments in different countries, investments outside Europe being explicitly recommended (Döring et al. 2007, pp. 12 and 45ff).

In such recommendations, risks due to changes in asset value, which occur particularly in cases of investments abroad, are often underestimated (Grabau and Joebges 2012). The biggest risk for investments outside Europe are changes in exchange rates. Exchange rates can increase the total return (in case of an appreciation) or decrease it (devaluation). If financial markets were in fact efficient, according to interest rate parity the difference in returns between the fixed-interest securities of two countries should equate to the expected changes in the exchange rates (e.g. Krugman and Obstfeld 2009, pp. 336ff). Therefore, financial investments abroad should not be more or less efficient than domestic investments. This connection cannot be empirically proven however (see Fama 1984, or more recent studies from Bekaert et al. 2007 and Pikoulakis and Wisniewski 2012).

Retrospectively, it is not difficult to find investment strategies which would have led to higher returns. But beforehand, without knowledge of future up- and down-turns and changes in exchange rates, the risk is high that wrong decisions will be made. In order to minimise risks due to changes in exchange rates, diversification via different countries (and therewith currencies) and hedging of currency risks is recommended. What

remains unsaid, however, is that on financial markets hedging for long-term investments such as those made by pension and life insurance funds is not possible (not by means of standardised futures anyway).[5]

Because they often guarantee a certain minimum rate of return to their customers, the funded pension and life insurance plans are thus dependent on a higher rate of return on the deposited capital from the market. In this regard, debt-based assets seem to present only limited risk, because the future payment of interest on the loan is already fixed at the time of issuance. If the fund holds the loan to maturity, it retrieves the nominal value of the asset from the debtor unless he is not able to pay.

Why is there an exchange risk even when holding these assets to maturity? At some point, changes in the value of a loan due to exchange rate fluctuations must be dealt with in the balance sheet of a funded pension scheme.[6] If, for example, a loan over a contract period of 10 years is acquired for 100 euros on issuance, but after one year is valued at only 50 euros on the market, the fund has to depreciate the value by 50 % even when the asset is held to maturity. The subsequent write-down of the fund‘s assets can, in the worst case, lead to insolvency if the losses due to exchange rate fluctuations cannot be made up for through other value generators or equity capital. As can be seen from the euro crisis, major fluctuations in exchange rates can occur even in the short run.

In the case bonds denominated in foreign currencies, negative exchange rate effects are especially troublesome and lead to high risk: Insurance companies in the euro area report their financial statements in euros. Therefore, the high total returns from foreign currency loans can be nullified or even over-compensated for by harmful exchange rate fluctuations (appreciation of the euro). This can make the financial investment unprofitable in the long term, and not only temporarily. Contrary to temporary losses on securities in euros, in which case – normally – the total nominal value of the asset is returned in euros at maturity at the latest, the exchange rate effect of a foreign currency may result in a repayment at maturity, which, in euro terms, is lower than the original nominal value. Therefore, it is imperative to calculate this risk when investing in foreign currency securities.

When the exchange rate risk is considered, even the supposedly safe national bonds of OECD countries outside Europe lose their attractiveness – including for the period before the euro-crisis (Grabau and Joebges 2012). Exchange rate risks also explain why, according to the statistics on the capital investments of primary pension providers[7] from the Federal Financial Supervisory Authority (BaFin), funded pension providers in Germany rarely hold foreign assets even though levels of national bonds of OECD countries held are unrestricted and there is no requirement for backing capital because of their zero-risk weighting.

Apart from the exchange rate risk, there is another risk of loss which is considerably higher for developing and emerging countries – although this risk cannot be completely ignored for industrial countries either, as the euro-crisis in the case of Greece has shown lately. The financial markets of emerging countries are often unable to absorb high capital inflows without economic distortions, as has been shown by the numerous financial and currency crises due to high capital inflows in emerging countries (Mexico 1994, crisis in Argentina 2002), most strikingly during the Asian financial crisis of 1997/98. If the associated default risk is considered, the allegedly higher returns are put in perspective: Coudert and Mignon (2011) show that for 18 emerging countries the higher returns only compensate for the higher default-risk.

Foreign investments do not limit demographic risks

It is often argued that the funded pension system is less exposed to demographic risks than the pay-as-you-go system, because capital assets can be invested internationally – and therefore also in countries with a population aging more slowly than Germany´s (see, for example, Schnabel and Ottnad 2008). An under-estimated problem in this case is the lack of appropriate target countries: If it was only about finding countries with better age structures and higher growth, and therefore higher returns on financial investments, it would not be

[5] Exchange rate risks can be managed well for up to a year on the capital markets – at least for widely-traded currencies. With higher volatility of a particular currency, however, the costs of covering the exchange rate risks increase. Funded pension providers in different countries can of course offer bilateral security, but this has related costs and eats into the returns one can expect.

[6] When operating in accordance with the German Commercial Code (HGB), a funded pension provider must comply with the strict ‘minimum value principle’, whereby write-downs are included in the balance sheet only when they become permanent. If the institution is operating along the guidelines of the International Financial Reporting Standards (IFRS), then all value fluctuations must be recorded in the balance sheet, except when state bonds are held on the non-trading book with the intention of holding them until maturity. In this latter case, the reporting of value can be considered broadly similar to the Commercial Code.

[7] Http://www.bafin.de/SharedDocs/Downloads/DE/Statistik/2011/dl_kapitalanlagen_4q_11_va.pdf?__blob=publicationFile&v=3

that difficult. At the same time, the economies of these countries should grow sustainably, be politically stable and above all have financial markets of sufficient size so that foreign capital inflows do not lead to economic distortions. Additionally, they should offer attractive export products (Barr and Diamond 2006): If the currently active baby-boomers initially invest abroad and then cash in on their investments when retiring, this would mean for the countries of investment that they would be confronted with increased capital inflows which would then convert into capital outflows as soon as the baby-boomers retire, with the expiring financial assets not completely compensated for by new investments – unless the released assets are used to buy products from the country of investment.

The accumulation of investments abroad means capital inflows to the countries of investment. If the financial market of the country of investment is too small to absorb them, this would lead to a considerable appreciation of its currency vis-à-vis the euro which would increase the cost of purchasing foreign assets for German investors. Additionally, high capital inflows can lead to asset price bubbles (especially on the equity and property markets) in the country and thus affect economic development – and therefore the returns. Even China, a big emerging country which should be well able to absorb high capital inflows, makes an effort to limit and channel capital inflows by controlling capital transactions.

An increased cashing in on financial assets involves inverse exchange rate effects and thus a devaluation (or in the worst case the bursting of bubbles in asset markets), so that in the end from a German perspective, and specifically for the baby-boomers, considerably less financial assets in euros would be available than originally expected. An optimal country of investment can therefore not exist: As soon as investors may have identified one as such, the resulting financial movements would reduce the expected returns in the currency of the investors. Further, it is questionable to what extent emerging countries are willing to take in capital on a large scale from ageing industrial countries. As a result of the lessons from the financial and currency crises caused by volatile capital inflows, the successful emerging countries in particular are rather net capital exporters that net capital importers (World Bank 2011). China is the most obvious example.

The probability of there being negative effects due to capital movements is intensified by the fact that not only Germany is ageing. Most industrial countries register similar ageing problems (Döring et al. 2009), so that not only Germany is interested in alleviating demographic problems through investments abroad. This leads to an increasing possibility of synchronised net capital inflows from industrialised countries, and also the corresponding phase of net capital outflows from the countries of investment which would lead to stronger exchange rate reactions and also stronger economic distortions in the countries receiving the investments. With this in mind, it is improbable that the realised returns will correspond with the high expectations. It should not be overlooked that some emerging countries also have an ageing problem, particularly China because of its one-child policy, which will probably complicate returns on investments for the present active German savers in their pension phase.

Overall, considerable doubts arise as to whether a funded pension system is more demography-proof and brings higher returns than a pay-as-you-go system. In the following chapter a return comparison between the funded Riester pension and a pay-as-you-go financed statutory pension is carried out.

Is the Riester pension worth it?

A comparison of returns

Principally, returns can be calculated for both pension systems. While the so-called "internal return" of the statutory pension system is calculated as a constant interest rate of which the sum of the interest-yielding contributions up to the start of retirement corresponds with the present value of the future pension payment (Ohsmann and Stolz 2004), the Riester pension distinguishes between the return in the saving phase and the return in the retirement phase. In the funded system the return in the retirement phase is indeed influenced by the return in the saving phase, but furthermore it also depends on the correct estimation of life expectancy, the adjustment of pension payments and the explicit and implicit costs and losses of the pension provider.

Instead of an assumed high financial market return of 4 %- 4.5 % over the total contract period (saving and pension period) which in many publications (e.g. Börsch-Supan and Gasche 2010) is the presumed interest rate paid out to the contributor, the result may be a considerably lower return in the actual pay-out. This return is central for the pensioner or Riester-saver. Only this return may be compared to the implicit return of the statutory pension system. Within each of the systems, the respective returns also depend on individual factors such as age, gender and family status. These factors hinder the drawing of general conclusions.

Additionally, there are a number of fundamental differences between the statutory pension system and the Riester pension which further complicate a comparison of the two. Unlike the individualised Riester pension, the statutory pension system covers a series of risks other than the standard old-age pension. The German Council of Economic Experts therefore writes that a comparison of the deduced implicit returns and the returns of a funded pension scheme does not make sense, because apart from old-age pensions, the statutory pension system also provides invalidity pensions, widows' and orphans' pensions, rehabilitation/re-integration benefits, and provides disability payments for older members of the work-force (SVR 2003, p. 222). According to Ohsmann and Stolz (2004, p. 57), the percentage of contributions which relates to this additional coverage should be factored out of the total. They estimate it at 20 % of the total contributions of the statutory pension system.

The costs of these extraneous benefits are not paid for through contributions to the statutory pension system, and thus lessen the return. While the government grant that should compensate for these costs does indeed increases the returns, it is not sufficient to balance fully these additional burdens (Reineke 2012, Meinhardt and Zwiener 2005). An increasing ratio of pensioners to contributors lowers the returns, while higher life expectancy and wage increases boost the returns for the present pensioners.

Weak returns of the Riester Pension

The high returns which the pension providers have achieved on the financial markets in the past have not been passed on through the corresponding interest rates paid on the contributions into Riester contracts. An essential reason for this are the high costs, open and hidden, of the Riester contracts (Oehler 2009). A regular evaluation of Riester contracts is, up to now, not foreseen and there is no planned legislation. Therefore, the following analyses necessarily rely on model calculations.

Only with optimistic assumptions and for Riester contracts which have been signed before 2011 do the model calculations manage to produce attractive returns: Women and men with contracts signed in 2001 at the age of 35 can count on a maximum return of about 3.9 % (profit-sharing plans; see Table 1, Kleinlein 2011). In the latest unisex-plans from 2011 the expected returns (including profit-sharing) decrease to 3.59 % for women and to 2.98 % for men. With newly developed products from 2011 the returns are even lower.

For some time now a considerable reduction in returns on all sorts of funded pensions and life insurance can be observed in Germany. Since 1994, the Federal Ministry of Finance has correspondingly made four reductions to the guaranteed interest rate (the 'maximum technical interest rate') on contributions into life insurance plans: from 4 % at that time, down to the current rate of 1.75 %. This interest rate defines the lower limit for the pay-out during the pension phase. Thus, employees who have signed a Riester-pension contract in 2002 have been guaranteed an interest rate of 3.25 %, while for signees in 2012 the guaranteed rate is only 1.75 %. The contracts are indeed supplemented through profit-sharing, but in the future these returns will turn out much lower due to the pension providers having to first use any surpluses to meet the higher guaranteed rates in the old contracts. This means that new contracts will not, or will only partly, get a share of the profits potentially generated.

All model calculations are based on the optimistic assumption that both in the saving and the pay-out phases the fund itself would achieve a return of 4.5 % on the cumulative savings contributions including government grants. However, the reduction of the guaranteed interest rate indicates that even in the saving phase it is highly probable that a considerably lower rate of return should be expected for the contributor. For new customers, for example, the guaranteed return on contributions to a private pension plan with a contract period of 25 years will be lower than 1 % (Krohn 2012). The pension providers are currently under pressure to build up reserves in order to ensure that the older contracts with guaranteed returns of 4 % can be fulfilled.

Taking the total contributions (own contributions plus grants) in the contracts as a basis for calculation, many savers will probably not live to see the time when the accumulated capital, without interest, would be distributed. With the new contracts from 2011 women and men would have to live to 87 years old in order to reach this point. The reduction of returns in the new contracts is explained on the one hand by the lower guaranteed interest rate, but mostly by a lower share of the surpluses for the contributor and by the new life tables used by the pension providers, which in comparison to those of the Federal Statistical Office assume a considerably higher life expectancy and therefore lead to lower pension payments (see Hagen and Kleinlein 2011).

Higher returns for the statutory pension

Schröder (2011) analyses a sample for the public pension beginning from year 2005 (Schröder 2011 and Table 1). In his calculations, the rate of return

TABLE 1

Returns on the statutory and Riester pensions - Men

Study/Source	Year of retirement	Pension system	Dynamic adjustments	Form of returns	Returns (in %)
Schröder (2011)[1]	2005	**Statutory pension**	0 % in the pay-out phase	Internal returns	3.17
Ohsmann/Stolz (2004)[2]	2004		Follows the financial model of the statutory pension (Estimates from 11/2003)		4.00
	2030				3.00
	2040				3.00
Kleinlein (2011)[3]	2033	**Riester pension** - Standard scheme 2011	Pay-in phase: 4 % of gross earnings	Rate of return	2.60 / 3.89
	2043	- Standard scheme 2011	Pay-out phase: dependent on shared profits	without / with profit-sharing	0.69 / 2.98
	2043	- newly developed scheme 2011			0.13 / 2.35

Returns on the statutory and Riester pensions - Women

Study/Source	Year of retirement	Pension system	Dynamic adjustments	Form of returns	Returns (in %)
Schröder (2011)[1]	2005	**Statutory pension**	0 % in the pay-out phase	Internal returns	4.75
Ohsmann/Stolz (2004)[2]	2004		Follows the financial model of the statutory pension (Estimates from 11/2003)		4.60
	2030				3.60
	2040				3.60
Kleinlein (2011)[3]	2033	**Riester pension** - Standard scheme 2011	Pay-in phase: 4 % of gross earnings	Rate of return	2.58 / 3.91
	2043	- Standard scheme 2011	Pay-out phase: dependent on shared profits	without / with profit-sharing	1.28 / 3.59
	2043	- newly developed scheme 2011			0.75 / 2.98

[1] Schröder (2011) calculates the internal return of the statutory pension based on a panel of pensioners who retired in 2005. Their contributions are known. For the future, life expectancy is based on projections of the Federal Statistics Office, while no increases in the pensions are assumed.

[2] Ohsmann/Stolz (2004) assume a legal status which takes the Sustainability Act into account, but which does not include changes to the retirement age. The higher retirement age leads to increased contributions and higher pensions. The impact on the rates of return can´t be assumed to be negligible. The calculations refer to standard pensioners who have contributed for 45 years.

[3] Kleinlein (2011) generates estimates using specific assumptions (e.g. capital market returns of 4.5 % pension providers, life expectancy tables, inclusion of costs, etc.). The estimates quoted above are for a Riester contract signed by a 35 year old.

Sources: Schröder (2011), Ohsmann/Stolz (2004), Kleinlein (2011).

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on the contributions (including the employer‘s contribution) on average amounts to 3.26 % in the statutory pension system. The differences between men and women, but also between pension forms, are considerable. The highest interest rate of 4.75 % is received by women who qualify for a standard old-age pension. Men in this category receive an interest rate of 3.17 %. The return for

men starting a standard old-age pension in 2005 therefore lies almost one percent under the return which Ohsmann and Stolz (2004, p. 62) have calculated for those who began their pensions the year before. Apart from a different methodological approach[8], the difference between the estimations is mostly due to the fact that Schröder's approach is very conservative: The pension payments of the future are taken to be nominally constant at the 2008 level, while Ohsmann and Stolz base their projections for the pension system on a financing model which assumes increases in salaries and therefore increases in pension payments. In the long term, because of pension reductions, the nominal internal returns for men and women will sink by about one percent by the year 2030 (for those born in 1965).

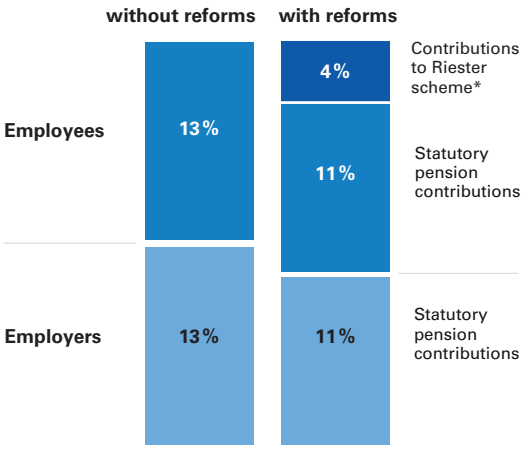
Table 1 summarises the results of the studies assessed here. It provides a rough overview of the features of different calculations of returns, as well as the variations between them – especially with relation to men and women, and to differing years of entry into retirement. The returns themselves are only comparable with qualifications: Schröder (2011) and Ohsmann and Stolz (2004) assume different pension adjustments and refer to a different legal status. Schröder (2011) also examines only present pensioners, while the other studies (also) generate calculations for future pensioners. In their calculation of returns, Ohsmann and Stolz also factor in costs from reduced earning capacity pensions and surviving dependants' pensions.

Comparing these returns, in the statutory pension system the interest rate for women – even though the assumptions are in some respects very conservative – is higher than in the Riester contracts from 2011 including the assumed high profit sharing. Also for men, the maximum interest rate for Riester contracts sinks lower than the returns which Schröder (2011) or Ohsmann and Stolz (2004) have estimated for the statutory pension system. Only in Riester contracts from 2001, and with the presumption of continuously high profit sharing, do the returns seem to be at first glance a little higher than those from the statutory pension system. But considering the return-lowering effect of the coverage needed in case of early retirement due to invalidity, and the additional financing of dependants, the pension reforms with their pension level reductions in combination with the increasingly worse returns from the Riester pension will have disastrous effects for pensioners and employees subject to social insurance contributions.[9]

FIGURE 1

Pension Reform and Contributions Rates

In order to maintain the pension level from the year 2000 until 2030, contribution rates of 26 % are required, which are paid by:



[1] Maximum subsidised contribution level.

Sources: Dedring et al. (2010), IMK.

IMK

Do the pension reforms pay-off for the younger generation?

Two of the basic justifications for the pension reforms were the expected demographic developments and the associated reduction of the burden on the younger generation. However, for both issues the pension reforms fail to provide a solution. The future ageing of our society requires unavoidably higher expenses for pensions, but also for care and health services. Therefore, younger employees only ostensibly profit from the pension reforms. Their contribution load does indeed sink, but their pension level is also lower. Because of the reforms they have to save at least twice as much for their additional private pension plans than they receive in relief from contributions to the statutory pension through the reforms (see Diagram 1). Besides, the danger of further pension level reductions exists for this (and coming) generation(s), because with a birth rate of 1.3 children per woman the social ageing process is going to continue, and the coming generations will again find themselves confronted with the problem of fair financing and sufficient security.

[8] The influence of varying the year taken as the beginning of retirement is ignored.

[9] Particularly because they finance the grants for the Riester contracts themselves with their tax contributions. Pensions of civil servants have not been subject to pension level reductions.

Macroeconomic Effects of the Pension Reforms

Cost relief for the employer

On the one hand, it is undeniable that the reforms have curbed the potential increases in the contribution rates to the statutory pension for the employees which would have kept the pension level higher. But on the other hand, they have to bridge the emerging gap through additional private pension plans. Employer involvement is not envisaged. In the future, when the pension contribution rate hits 22 percent, employees will have to invest 15 percent of their gross income to privide for old age security: 11 percent will be their half-share paid into the public pension system, plus 4 percent for the Riester pension. In this scenario, the financial burden for the employee is higher than if the contribution rate without reform had risen to 26 percent. In this case, the employees' contributions would only be 13 % (Figure 1). As it cannot be assumed that employers would succeed in passing on a rise in their statutory pension contribution rate onto wages in wage negotiations, the employees are comparatively better off with parity-based financing. A partial passing on of the higher unit labour cost onto the prices which affect domestic customers and foreign countries is probable. Jobs could be lost in the case of negative growth effects. But cost-sharing by employers certainly improves the income situation of both employees and pensioners, and therefore also the levels of private consumption. In the end, the effects on growth and employment would be quite limited. The argument that simply lowering the non-wage labour costs will lead to more employment is neither valid nor sound, because developments in levels of employment depend primarily on growth. If employees save additionally the amounts that were previously paid by the employers, they unavoidably have to reduce their spending on private consumption. This provokes negative macroeconomic effects and not positive ones, as is assumed in supply-based theoretical models. As a result, employment and wages turn out lower (Logeay et al. 2009).

Lowering the costs for employers does improve the competitiveness of businesses with respect to prices. However, the stated aim in the pension reforms of stimulating economic growth via the improvement of international competitiveness through a reduction in the employer's contribution rates is severely flawed due to non-domestic problems (Joebges et al. 2010). The reform measures came into force at a time when Germany was already moving from an approximately balanced balance of trade towards increasing surpluses. The reduction of the contribution rates for employers leads to higher exports due to the related improvement in international competitiveness, while at the same time the increase in the aggregate savings ratio of private households has subdued domestic demand and imports. A positive impulse for growth could not be generated (Meinhardt et al. 2009). Back then, the measures were already running against the Stability Act which, amongst other things, propounds balanced balances of trade.[10]

Additional accumulation of savings?

As the previous chapter illustrates, one of the arguments put forward for the introduction of the funded system are higher private savings than in the pay-as-you-go system. Theoretically, the increase in private savings should reduce the cost of capital borrowings for businesses and stimulate economic growth through higher investments.

But have private savings increased due to the pension reforms? Empirically we observe that the private savings rate had decreased over a number of decades until the beginning of the 2000s, and has increased again from 2001 to 2008. An analysis of the reasons for this is difficult though. Apart from the pension reforms, in the first half of the last decade there have been numerous labour market and tax reforms. These led to a massive redistribution in favour of capital incomes and high-end wages (Logeay und Zwiener 2008, Truger et al. 2010, Goebel and Grabka 2011). This redistribution of incomes in favour of high-end wages could be the primary cause for the increased private savings rate (Logeay et al. 2009).

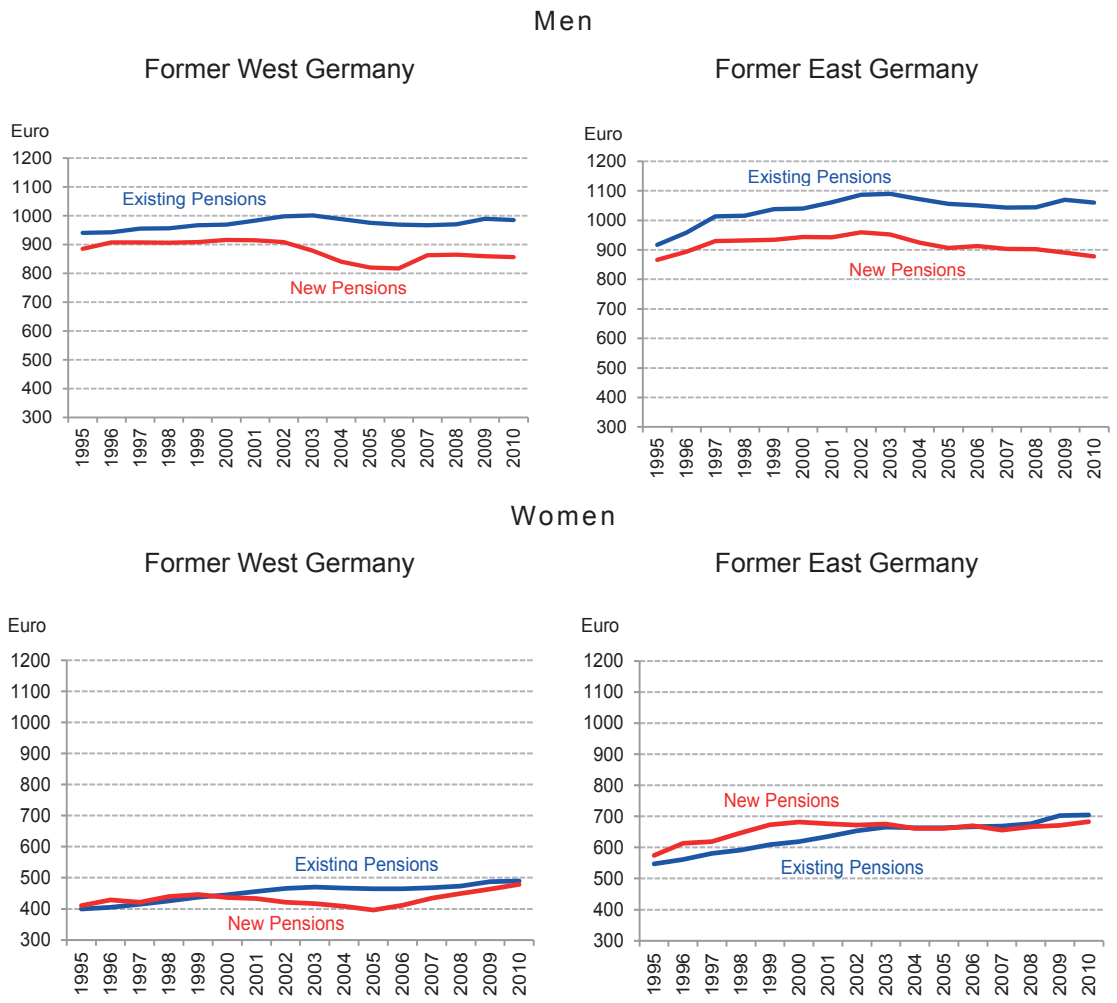
Studies by Coppola and Reil-Held (2009) and Corneo et al. (2009, 2010) also show, using data from household surveys (SOEP and SAVE), that the Riester pension system is also affected by opportunistic behaviour – many households do not save additionally, but households that would save anyway avail of the government grants on the Riester pension.

When carefully interpreting the data, it can be assumed that the Riester pension has contributed to the increases in the private savings rate. But this is due specifically to two top income quintiles, while the three lower income quintiles show little additional savings (see also the interpretation in Schröder 2011, p. 16f.). Therefore, the absolute number of Riester contracts cannot be used as an

[10] http://www.gesetze-im-internet.de/bundesrecht/stabg/gesamt.pdf

FIGURE 2

Pension benefit[1]



[1] All old-age pensions.

Sources: DRV 2009/ 2011; Calculations from IMK.

IMK

indicator of a successful increase of retirement savings, especially given that the first results after ten years of Riester saving are sobering: Not even half of all eligible people have a Riester contract (Fassbauer and Toutaouvi, 2009).

The situation for households with low incomes or interrupted employment biographies is particularly problematic (Blank 2011). The proportion of households without Riester contracts is even lower here, with the poor financial situation of these households being the crucial factor.

In the lower and medium income brackets, the money for Riester savings is simply not there or often other saving plans are switched to Riester plans in order to get the government grants. In both cases the households are hit hard by the pension cuts. In the first case, the supplementing of low pensions through the Riester system is missing. But also in the second case, where the accumulation of savings is only transferred to the Riester system the old-age provisions are considerably worse. Without the reforms, these households would originally have supplemented their full public pension through their private savings which they would have had anyway. The level of other savings is automatically lower if the funds are partly transferred to the Riester system. These households, too, are thus heavily affected by the pension reform because their overall income deteriorates accordingly during the pension phase.

Only those households with higher incomes can balance the future pension cuts by increasing their savings rate. Evaluations of SOEP-data show than only this group has appreciably increased their savings rate in the past decade (Stein 2009). These households will not even have to dissolve their private savings in old-age as they will probably be able to live on dividends and income from rent in addition to their pensions.

A planned increase in the volume of savings from employee-households – for example through priva-

te pension plans – does not automatically lead to higher investments and therefore a higher stock of capital. Low demand for consumption, caused by more saving, has a negative effect on private investment activity and therefore ultimately leads to losses in growth. Consequently, incomes and employment decrease, public deficits increase and profits of businesses decrease. Macroeconomically, the attempt of one sector – in this case employee-households – to increase its savings can lead to a lower macroeconomic aggregate savings rate.

This generates a dilemma for the employees: If they save additionally, they will reduce economic growth and therefore also their own incomes should other sectors not spend more (i.e. the state, businesses or foreign countries). If they do not save additionally, they will not have the necessary reserves later and will be heavily affected by the pension level cuts.

The funded system has a pro-cyclical effect

The instability of the funded system has strong short-term destabilising effects on economic activity. In the USA some pensioners were forced to work again because of decreasing pension payments. In a crisis with mass redundancies, they represent competition to the unemployed for already scarce jobs. At the same time, elder employees postponed their planned entry into retirement (Rampell and Saltmarsch 2009).

In comparison with the funded system, the pay-as-you-go system is not only more crisis-proof but also has a stabilising effect on economic activity. The better resistance to crises is due to the comparatively stable income basis, which is derived from the gross pay and incomes of social insurance-paying employees, which at the same time acts as a guarantee for the pay-as-you-go system not going bankrupt. The stabilisation of economic activity – at least at the beginning of a crisis – is due to the delayed adjustment of expenditure to developments in the gross income per capita subject to contribution payments (Meinhardt et al. 2009). Revenue deficits in the crisis are first balanced by sustainability reserves or the federal budget.

Pension Gaps and Impending Old-Age Poverty

Developments in the pension level

In comparison to wage increases, the statutory pensions have risen minimally since 2002 because of the Riester factor and, from 2005, the sustainability factor in the pension formula. At the same time the pension level of new pensioners (on standard pensions) has dropped further behind the level of existing pensioners. Already since the middle of the 1980s, the average amount paid for new old-age pensions for men is less than the amount paid for already-existing comparable pensions. In the middle of the 1990s the difference between those two pensions amounted to 50 €, this difference has increased up to 130 € per month for men in the states of the former West Germany. The total amount paid for new pensions has decreased since the turn of the millennium, and in 2010 the level for new pensions has fallen to that of the beginning of the 1990s (DRV 2011). Even though the present pension value has increased since the middle of the 1990s (despite insufficient increases in wages) the overall economic improvements have bypassed new pensioners (Figure 2), if because of nothing else than their having been affected more by periods of unemployment which reduces the increases in pension entitlements since the reforms.

For men in the states of the former East Germany, the average amounts of new and existing old-age pensions are drifting apart even more strongly than in the western states. For women, the developments in pensions have been influenced by evolving employment patterns. The amount paid to existing and new female pensioners has on average increased since the middle of the 90s, and the difference between the amounts paid to existing and new pensioners has decreased. But it must be noted that the average old-age pension for women in the west of Germany only reaches 55 % of the pensions paid to men.

The faltering development of pensions as against wages also manifests itself in the "pension level" indicator.[11] Even the "standard pensioner" is a victim of the massive income redistribution and the low wage increases of the past decade. The lower valuation of a slow-growing average wage leads to a corresponding pension which falls behind overall wage developments. The German Council of Economic Experts (SVR) estimated in 2003 that if the recommendations for the pension system of the Rürup Commission on old-age security were brought into force, then the gross pension level of the standard pensioner would drop from 48 % of the average income of all contributors in 2003, down to 40 % of the average in 2030. Taking net spending capacity with constant real wages, this corresponds to a reduction of the average pension for long-term contributing men from its 2003 level

[11] For a definition see Infobox 1 – Standard pensioner and different pension levels.

of 1,168 € to 973 € in the year 2030. Even the total pension level – which is defined as the relation between the public pension plus Riester pension and the average gross income – will decrease a little for the standard pensioner despite the inclusion of the Riester pension with its optimistic assumptions regarding the attainable returns (SVR 2003, item 349, pp. 227 and 228).

Estimates from the Association of German Pension Insurers show that the deferred taxation which has been introduced years ago reduces the total pension level even more, for example by 6.3 % for the newly retired in 2030. The net pension level for future pensioners thus decreases more than is apparent at first sight. Despite the increased financial involvement of the employees, this level is considerably lower than if there had been no pension reform.

How big will the pension gap be in the future?

Börsch-Supan and Gasche (2010) analyse, using various assumptions, to what extent the pension gap resulting from the reforms can be closed by the Riester pension. They compare estimates on the basis of the pension reforms of 2001 and 2004 with estimates of pensions without these reforms, while considering only old-age pensions and the arising gaps between these two hypothetical pension scenarios. Other benefits of the public pension system, for example early retirement pensions and the dependants' security system are left out. They analyse under which conditions the resulting gap can be closed by pension payments from Riester contracts. They contemplate both gaps at the start and over the course of retirement. Under the assumption of a 3 % wage increase for the year 2030 the pension payment will drop by 14.4 % due to the pension reforms, which means a difference in the pension level of about 7 % (Börsch-Supan and Gasche 2010).

In the baseline scenario of their analyses, the Riester capital yields returns of about 4.5 %[12], the value of the pension payment has a built-in adjustment of 1.5 %, and the future wage increases at a rate of 3 %. A closing of the pension gap depends primarily on the interest rate of the Riester pension, future wage developments, the duration of the saving process, and the possible adjustments to the Riester pension. In a phase of high interests on the financial market and low wage increases, the gap at the start of retirement start can be covered. But in the case of a normal situation, with lower financial market returns and high wage increases, the gap cannot be closed. All these simulations relate to the case where a Riester contract has been signed. A gap results for all people who are affected immediately by drops in the pension level and who have no possibility to compensate for it. This applies to all pensioners and the age-groups approaching retirement. Even if they sign a Riester contract, the contract period of the saving process is not sufficient to cover the difference. People who cannot afford additional savings will have a pension at least 16 % lower. After all, at present not even 50 % of all eligible people have a Riester contract.

The fact that Riester savers do not receive any support through an employer's contribution and, subsidies aside, they have to maintain their contribution rates themselves, is completely ignored. This means that they have to save additionally or transfer other savings into the Riester plan, which will then be lacking in old-age. The latter represents an additional pension gap which is not considered in the model examined above.

Other estimations tend to show even higher future pension gaps. The OECD estimates a pension gap of 15 % for the average German earner – measured with a view to securing living standards in old age (OECD 2011). The Deutsche Bank foresees a future net pension gap of 10-15 % (Deutsche Bank Research 2005).

Impending old-age poverty

Up to now, the risk of poverty for current pensioners could be described as average when compared to the situation of the total population (Goebel and Grabka 2011b). This, however, only applies to calculations of the needs-weighted income available for households. The income position of the individual is masked by the redistribution process within the household – whereby low incomes are balanced by a partner's higher income. In a one-person household the possibility for such a redistribution does not exist. Correspondingly, the rates of risk of old-age poverty is twice as high for single seniors (65 years and older) than for couples.

The pension and job market reforms of the past decade increase the danger of future old-age poverty. Currently, even politicians are starting to take seriously warnings of impending old-age poverty, and are half-heartedly constructing a supplementary pension, though this is still too little and claimants must fulfil too many conditions. From the outset it was foreseeable that the combination of

[12] This is based on the net returns of life insurances which were on average 4.7 % between 2002 and 2008. The net returns of the insurers do not correspond with the returns for the insured though, because other factors such as costs and profits have to be considered.

pension reductions and additional optional private pension plans with Riester savings would lead to old-age poverty, especially for lower income groups. Against the background of the high correlation between income and future pension, the situation has been aggravate by the politically-initiated measures concerning the job-market which have taken place at the same time – i.e. the relaxation of regulations related to temporary and part-time employment, and the subsidisation of so-called 'mini-jobs' which pay up to 400 € a month. Thus the number of mini-jobs has increased to over seven million since their introduction, and poorly-paid temporary work has spread. All these measures reduce wage increases and therefore inhibit increases in pension entitlements of the lower income-groups.

The reforms have put pressure on effective wages. Adequate wage increases and corresponding pension increases have thus been impeded. In the lower income sector, there is clearly a drastic impact from the combination of long-term real wage reductions, pension level cuts and interrupted employment biographies.

To compensate for the growing pension gap by themselves is hardly possible for these wage-groups. On the one hand, they usually cannot afford additional savings despite government grants. On the other hand, if someone is entitled to receive social welfare because of having a low old-age pension, he or she would rather not have a Riester pension plan as it would be deducted from the public benefits available (see Geyer 2011).

Comparing the German pension system in its present design to the old-age security of other OECD countries, Germany features a difference of 15 percent for an average earner when compared to the average of all 34 countries which have been analysed (OECD 2011). Comparing employees earning 50 % of the average income, Germany's security level comes last. Taking the net figures, the overall picture improves a little, but the gap remains some 10 % below the OECD average of 69 % and at the lower end when compared with the 34 countries analysed.

The low pension level in Germany is highlighted when one looks at how long an employee has to make contributions in order to be entitled to a public pension (security level before taxation) that covers the average basic cost of living (single person) of 660 € per month (in 2009). For the calculation we use the average income position (the average income for the year 2009 was about 30900 €), at the beginning of retirement an average employee needed to have contributed for twenty-seven years (that is to say he accumulates 27 'earnings points') in order to reach the basic security level. Given the present legal situation, in 2030 an employee would already need to have contributed for 32.6 years (i.e. 32.6 earnings points). If the contribution-paying employee only earns 75 % of the average income,[13] the number of years necessary in order to reach the basic security level increases from the current 36 years to 43.5 by 2030 (Dedring et al. 2010). The latest published calculations from the Federal Ministry of Labour show that even with a gross income of about 2500 € per month and 35 years of contribution payments, from the year 2030 a basic level of security for pensioners is barely reached (Berliner Zeitung from 3.9.2012)

The consequences of these levels on old-age poverty are presented in a research study looking at the effects of pension cuts and interrupted employment biographies on the basis of household data (Simonson et al. 2012). While for men and women from the former West Germany and even for women from the old east, the pension entitlements – measured in earnings points – remained almost unchanged compared to the previous old-age cohorts, for men from the former East Germany they decrease drastically by about 10 earnings points: While the average value for west German men (median) is about 48 points, the median value for east German men is only 32.6 points (Simonson et al. 2012).

The reason for the east German men doing so poorly is the stronger and more pronounced increase in interrupted employment biographies. The complete group of east German men with years of birth between 1956 and 1965 will have to cope with lower pension benefits compared to previous old-age cohorts. 50 % of the men in this cohort will have pension entitlements equivalent to the basic old-age security level. 25 % of the men in this cohort will only reach 26.3 earnings points. Measured by today's standards, they would then be entitled to apply for old-age social security to supplement their pensions, should they not have additional income. If at the end of their working lives, 50 % of this cohort of East German men have pension entitlements below the requirement limits for receiving social security, the question arises as to whether a pension system which does not even secure a basic level of subsistence can be justified.

What's more, particularly those people with interrupted working biographies do not generally have any property to support them in old-age. The proportion of people with Riester contracts is also low for this group. If no amendments are made to

[13] In 2010, 75 % of an average wage equated to a monthly gross income of 1916 €, or an hourly rate of 11.07 € on a 40-hour week.

the current pension regulations, for many employees it will mean inevitable old-age poverty. This group of people will probably not benefit from the additional pension benefits currently under discussion, because they usually do not meet the relevant conditions (i.e. of having a private pension plan).

The wrong path

The pension reforms from the beginning of the last decade were based on the dominant thinking of that time, that markets are more efficient than government institutions and that the state has to be rolled back. The experience of the financial crisis and the present euro crisis show how dangerous this doctrine is. Given the already high competitiveness of Germany back then, there was no pressing need to relieve businesses of costs and to pull back from the system of parity financing for the statutory pension. Instead of gradually developing the statutory pension into a system to serve all adult citizens (Meinhardt and Grabka 2009b), it has been weakened and the aim of securing living standards was abandoned. At the same time, the occupational invalidity pension scheme was dismantled, with only a rudimentary disability benefit being preserved. Employees with low incomes and/or interrupted employment biographies are further disadvantaged through the structures of the German pension system, which does not envisage any further support for them. In these respects, the German pension system is the most 'unsocial' within the OECD.

One of the aims of the cuts was to prevent the contribution rate increasing up to 26 % by 2030. Instead, the contribution rate should now rise up to a maximum of 22 %. The difference would have amounted to only about 4 earnings points, with the increase being spread over 30 years. Each year the contribution rate would have increased by about 0.1 percent in the case of wage increases of 2-3 %. Employees and employers would have hardly noticed it, and it would have had a minimal impact on German competitiveness.

It was erroneous to believe that demographic problems could be solved with these pension reforms, and that the younger generation would be comparably better off now. Those who are better off now are above all businesses, due to the reduction of their contribution rate and especially insurance companies with a new business segment. In contrast, the younger generation are considerably worse off because they will receive a much lower pension and, apart from a small government grant, have to pay for the necessary additional private pension scheme by themselves. The present employees have a double burden as they have to pay contributions for the present pensioner generation and additionally need to save for a future private pension.

Another erroneous belief was the trust in the efficiency of the financial markets and their promises of high returns. In this regard the effects of the financial crisis and the still unresolved euro problems have taught us better. The partial transition from the pay-as-you-go to the funded pension system (Riester pension) has proven to be a mistake after only 10 years. The financial markets have shown instability and high volatility. Without rescue from the international community they would have collapsed already. It is difficult to imagine anything but further decreasing returns on life insurance policies and write-offs on financial investments over the coming years. The idea that the Riester pension could bridge the gap caused by the pension reforms is clearly a mirage.

People providing additionally for themselves and/or their dependants through various private saving plans is all well and good, but it does not require subsidisation from the government. This leads to unnecessary possibilities for opportunistic behaviour. The government would be better advised to use the limited public funds specifically for pensioners in need within the public system.

Despite the weakening of the statutory pension system, its performance is better than that of the Riester pension. In particular, new Riester contracts offer very low returns. The private pension system does not cover universally, and therefore cannot close the gaps caused by the pension reforms. Thus, many are predestined to slip into old-age poverty. A statutory pension level that does not protect people from old-age poverty is simply not acceptable (Schmähl 2008). The state does not save in the end, because it has to intervene with support from tax money. What's more, the statutory pay-as-you-go system loses its legitimacy. Many of today's employees still mistakenly believe that with the combination of the statutory pension and Riester savings they will achieve an acceptable future pension. In order to make this a reality, a fundamental amending of the past pension reforms is necessary. The additional pension benefit envisaged by the Federal Ministry of Labour will not suffice. The statutory pension system has to be designed in a way that employees with an income of just under the average will, after 35 years of contributing, find themselves clearly over the basic security level without need for additional benefits.

So what should be done? The pension system should be returned to a mandatory national system

with parity-based financing from employers and employees. The long-term objective must be comprehensive cover for all citizens. The first step is to take the Riester pensions out of the overall pension calculations, especially since current pensioners are being affected by the resulting reductions without ever having had the opportunity to accumulate savings which could have compensated for these reductions. And because not even half of the people entitled to open Riester contracts have done so, their old-age security can also not be guaranteed.

Correspondingly, the subsidisation of the Riester pensions comes into question: Instead of a general subsidisation with no obligation to retirement-related savings, there should be a focussed supplementation of the pensions from low-wage earners and those with interrupted employment biographies in order to reduce the impending danger of widespread old-age poverty. Finally, government funds would also have to be made available for this social group, under the basic social security provision.

In the medium term, the objective must be to reach the OECD average for the pension level, which is currently a remarkable 15 % higher than in Germany. At present, that would translate into the pensions of long-term contributing men rising from 1,152 € up to 1,585 €. The fact that in numerous countries the old-age security levels are considerably higher indicates that such levels of security are sustainable. The financing of a higher basic level for the public pension can be provided through a combination of gradually increased contributions from employers and employees and a raising of the income ceiling, though above the existing contribution income additional pension entitlements would be accumulated at a proportionally lower rate.

In their current form, the deferred earnings transferred into company pensions reduce the overall cover provided by the statutory pension system as the transferred earnings are not only tax-exempt but are also non-contributory, thus reducing the current pension value. Those affected are the current and new pensioners. From the point of view of all employees, an optimal solution would be that these transfers remain exempt from taxes while making employee and employer contributions on the amounts obligatory.

The final pressing issue is that sufficient cover is provided through the public system for persons with disabilities or reduced earning capacity.

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