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SAFE Finance Blog

The Negative Effects of the "Respect Pension"

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Alexander Ludwig: Hubertus Heil's proposal for a tax-financed basic pension would solve some problems. Nevertheless, the concept would be expensive and could significantly increase disincentives to work



Hubertus Heil (Social Democrat Party of Germany), Federal Minister of Labor and Social Affairs, has proposed introducing a tax-financed basic pension. This should increase the pension for former low-income earners by a significant amount – up to 447 euros a month – and would probably cost several billion euros.

The initiative to introduce a tax-financed basic pension (<https://www.bmas.de/DE/Presse/Interviews/2019/2019-02-03-bild-am-sonntag.html>), as recorded in the coalition agreement, is trend-setting and would solve a well-known and often mentioned problem of basic

social care in old age. This is paid for example only on request and carries, therefore, a large number of unreported cases, because actually more people would have a claim on it.

If however, the basic pension is paid in addition to the one accumulated by pension points to date, this is not only directly expensive but could also significantly reinforce the already existing disincentives to work: In relative terms, work would be less attractive, because the basic pension would be paid in any case. Through this mechanism, the introduction of the basic pension would be even more expensive than the direct figures suggest.

I have already argued elsewhere (<https://safe-frankfurt.de/de/policy-center/publikationen/detailsview/publicationname/das-deutsche-rentensystem-thesen-zur-derzeitigen-diskussion-um-umkehr-reformen.html>) for a move away from the strict principle of equivalence in the German pension system. It says that the pension is linked 1:1 to the income during the employment phase, via the pension points. Instead, I suggest, it would be better to introduce a redistributive component. For a low earner, for example, the link would be 1:1.2 and for a high earner 1:0.8. The reasons for this proposal are manifold: This would be consistent with the idea of a life-long work income taxation and, thinking this fully through, it would also mean that progressive elements of the tax code during the employment phase would be reduced; less redistribution therefore here, more there. This view is also consistent with the understanding that pension insurance is more than just insurance of longevity. It ensures large and lasting employment risks, such as sickness, or, more generally, persistently low productivity during the employment phase. According to this concept, the basic pension would, therefore, be paid if the standard old-age pension, which contains the redistributive component mentioned above in addition to the remuneration points, is lower. Otherwise, the standard old-age pension would be paid, of course, including the new redistributive component, which would raise pension income of low income earners relative to the current legislation. However, this concept does not envisage payment of the basic pension as a supplement to retirement income, as proposed by Hubertus Heil.

The introduction of a general redistributive component as in the US in the German pension scheme and, in addition, a tax-financed minimum pension in the amount of the current basic social care would, in my opinion, be the right way. Then there will no longer be any need for what I consider to be a swollen term such as "respect pension".

Finally, a word on the means testing: according to the proposal of Hubertus Heil, this should be omitted. This is very good and is to be welcomed! The only "means testing" of my proposed concept is whether the standard old-age pension is lower or higher than the basic pension. On a more general level, the whole means testing of social insurance needs to be reexamined. It is complicated, it costs a lot - after all, someone has to check the neediness and these people could work productively elsewhere - and it creates an incentive to be needy. In other words, it takes away savings incentives, which is a loss of efficiency from an economic point of view. Of course, there are always injustices. To give just one example: the wealthy partner of a dentist, who hardly has any income of his own and thus benefits from a minimum pension or a redistributive standard old-age pension. However, all the injustices of the social system can never be solved, the principle of parsimony should take precedence.

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