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SAFE Finance Blog

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How to improve Germany's pension scheme

Demographic developments and low interest rates have consequences for the German pension system. In order to secure the standard of living in old age, financially viable and feasible measures are needed

An adequate pension is no longer secure for many citizens in Germany. On the one hand, this is due to the increasingly unbalanced ratio of pension contributors to pensioners, which increases strain on the pay-as-you-go system of the statutory pension. On the other hand, persistently low interest rates make funded occupational and private pension schemes with guaranteed contributions unattractive.

The three pillars of the statutory pension in Germany (contribution rate, retirement age, and financing from the state budget) cannot be extended any further against economic, political, and social resistance. Even the so-called Riester pension in its current form no longer offers any scope for an attractive and sustainable pension model. However, measures can be taken that can be implemented quickly and effectively with a view to the statutory pension insurance, a "share pension from birth," an improvement in the Riester pension, and active support for pension planning.

One-time payment at the start of the pension

First, one possibility is to create incentives for voluntary later retirement. A technically simple but effective measure is to pay out the supplementary pension resulting from the time extension not only as an increase in the monthly pension but also as a lump sum upon retirement. This results in manageable costs for the pension fund while at the same time providing a demonstrable benefit in that more people take advantage of this offer.

Share pension from birth

In the case of a "share pension from birth", a state-financed single premium is paid into a securities account for all newborns. The funds from this custody account are invested in a fiduciary capacity in globally diversified shares and funds and are not paid out until retirement. Thanks to the enormous long-term earnings of international productive capital, substantial assets can be built up for later life even with very small investment amounts and irrespective of the individual's employment biography. The very long-term investment horizon allows short-term fluctuations in returns to be balanced out over time. The bottom line is therefore a substantial additional pension for each and every individual in society, which at the same time avoids old-age poverty in future generations.

Reform of the Riester pension

To ensure that current cohorts also participate in productive capital for old-age provision, the contribution guarantee for the Riester pension can be adjusted. If the minimum payout at the end of the contract term for personal contributions remains guaranteed, but not the government subsidies, significantly higher returns and capital gains can be achieved. A reformed contribution guarantee in combination with standardized risk-based investment strategies could make the Riester pension more attractive not only at the national level but also at the European level if, as in the case of the Pan-European Personal Pension Product (PEPP), risk-equivalent investment strategies such as a lifecycle fund are permitted as an alternative to the contribution guarantee.

Pension planning support

Finally, people also need more transparency and support in their pension planning. The “Central Office for the Digital Pension Overview” (Zentrale Stelle für die Digitale Rentenübersicht, ZfDR) planned under the umbrella of Deutsche Rentenversicherung as an application for transmitting digital pension information is a promising first step. However, limiting the pension puzzle to a tabular representation of insurance-type benefits leaves gaps. Alternatively, data trustees can be promoted that offer people a meaningful overall view and encourage concrete decisions at an early stage.

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References

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SAFE Policy Letter No. 90 (in German)

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