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Germany's pension reform is only the start

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The new "generational capital" is only a homeopathic supplement

Last week, the German government unveiled the so-called generational capital: an additional capital fund that the state invests in the stock market to strengthen the mandatory state pension scheme with higher returns. The government will issue debt to finance this scheme. As long as the long-term yield of the stock portfolio exceeds the government's financing costs – which is quite likely – the pension fund will make a profit. This profit is intended to help stabilize active workers' pension insurance contribution rates. The generational capital is a long-term initiative, and the accumulated capital fund is meant to persist permanently. Only the returns are intended to assist in financing pensions.

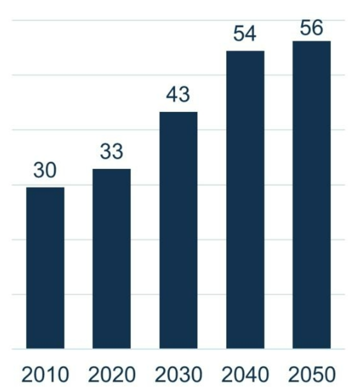
Initial contribution towards the capitalization of pensions

The statutory pension insurance scheme is in imbalance

Germany is past its prime. Even more than most other European countries, its society is ageing rapidly. The large number of baby boomers born in the 1960s are gradually approaching retirement but had collectively too few children. This poses a threat to the financial sustainability of the pay-as-you-go pension system, where the currently active workers cover the pensions of current retirees through ongoing contributions deducted from payroll.

The consequence of Germany's demographic imbalance: while in 2020, three workers supported one elderly person, by 2040, fewer than two young individuals are projected to support one elderly person (see figure). According to the rating agency S&P Global, the costs for German pension insurance will climb from 10.6% of GDP (2022) to 12.5% in 2060. In developed economies overall, costs will rise "only" from 8.4% to 9.6%. Without countermeasures, the total debt of the German state would grow to more

Old-Age Dependency Ratio
Number people at least 67-year-olds per 100 individuals aged 20-66



Source: LBBW Research, Destatis (Table A1) than 125% of GDP over the years (assuming 2% interest on government debt). The system urgently needs strengthening.

By 2030, state debt could rise to 125% of GDP

Too little, too late

However, the generational capital is not sufficient to bring pension finances back on an even keel. It comes too late and is too small to fundamentally change the shaky public pension system. For that, ageing has advanced too much already.

Just look at the numbers: the total expenditures of the pension insurance amount to almost 400 billion euros, of which more than a quarter is already financed by transfers from the federal budget. The targeted annual 12 billion euros in stock purchases represent 3% or, in other words, less than two weeks of the system's annual expenses. And since only the *returns* from the stock investments are intended to support the pension scheme, the actual contribution to pension costs is even much smaller. The German generational capital is thus more of a homeopathic add-on than a real systemic change. The train for the latter has left the station due to advanced demographic shifts. The stock market cannot save the system alone.

Get more people to work longer!

Therefore, the pension system must be urgently reformed and stabilized. Politicians must create stronger incentives for more people to work and to work longer. It should link the retirement age to life expectancy and facilitate targeted immigration. Also, the underutilized potential of the workforce should be mobilized – I am thinking here of the part-time epidemic, especially among women. These are the main roles in the pension reform movie. In comparison, the unveiled generational capital can only play a tiny supporting act.

The pension system needs bolder reforms