COUNTRY SPOTLIGHT GERMANY

The ticking of the clock

Despite being Europe's financial and industrial powerhouse, the German pension system is beginning to struggle with an ageing population. Pete Carvill **reports**

Germany is a European powerhouse: The largest economy on the continent, with robust infrastructure, a stable – although often troubled – government, and arguably the leading political voice within the European Union.

However, outside of Germany, little is known about its pension system, nor about how it may be one of the nation's great stressors as demographics shift over the next two-to-three decades. It is a system that rests on three pillars: The statutory pension insurance, occupational pension schemes, and private plans.

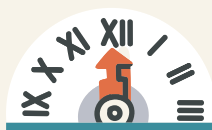
Most pensioners in Germany rely heavily on the first pillar scheme. As the Federal Ministry of Labour and Social Affairs wrote last year, in its *2024 Ageing Report*: "These schemes provided old-age pensions, as well as survivors and disability pension claims to (more than) 90 per cent of the employed population in 2022. Currently, the general pay-as-you-go earnings-related first pillar statutory pension scheme covers about 87 per cent of the employed German population, whereas the public civil servants scheme protects approximately 5 per cent. Both systems accounted for pension expenditures of about 10.2 per cent of GDP in 2022."

But it would not be Germany if there were not added layers of bureaucratic complexity. According to the company's Ministry of the Interior: "Other important schemes include the civil servants' pension scheme, retirement and surviving dependants' pension for public service employees, farmers' old-age security, artists' social insurance and pension funds of the free professions."

It is also a system that is beginning to strain under an ageing population. According to the Robert Koch Institute, Germany's ministry for health, the proportion of the German population aged 65 or older will increase from the current level of 21 per cent to 29 per cent by 2030. In 1991, that figure stood at around 15 per cent, according to figures from the Federal Statistical Office.

Risings costs

But even as government expenditure on pensions has remained steady since the 1950s, statistics published in February this year revealed that more than a third of the federal budget, €176.8 billion, was earmarked for the Federal Ministry of Labour and Social Affairs, which administers the German state pension. Nearly three-quarters of that is set aside for pension insurance and basic security for the elderly and those unable to work.



"PEOPLE SOMEHOW STILL HAVE THIS IDEA THAT THE FIRST PILLAR SHOULD BE ENOUGH. THIS IS NOT TRUE; THEY HAVE TO SAVE"

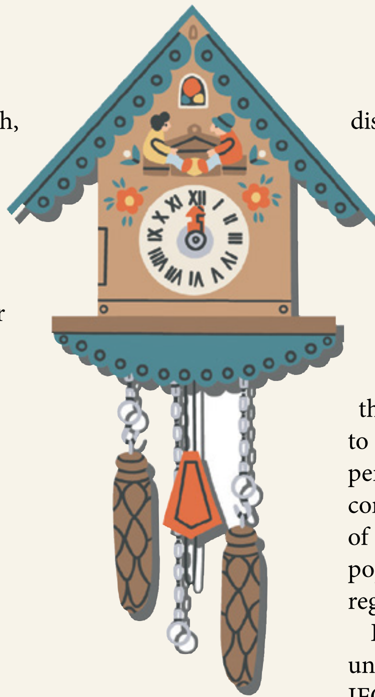
Second- and third-pillar pension schemes are largely an afterthought. According to Deloitte partner, Claudia Veh, nine out of 10 senior citizens in Germany get a pension through the first pillar, with nearly three-quarters of old-age benefits coming from the same scheme.

She adds: "Benefits from company pension schemes, the so called second pillar, make up 8 per cent of income in old age, whereas private provision, the so called third pillar, accounts for only 7 per cent. Of course, this varies from individual to individual. Many cannot afford to invest in a private pension contract or do take part in salary deferral-programs at their employer."

Even the International Monetary Fund (IMF) has weighed in, writing that the annual growth rate of the country's working-age population is expected to fall by around 0.7 percentage points, the worst slowdown of any G7 country and slowing annual economic growth to 0.7 per cent over the medium term. There would also be a concurrent hit to public finances due to a slowdown in tax revenue growth against a rise in pension and healthcare spending.

There is a tacit recognition that the current system will not last, says WTW Germany's retirement managing director, Michael Karst. Despite incoming legislation that looks to tackle these problems, he says that the population knows that the level of first-pillar pensions is going to fall. This, in turn, leads to a decrease of trust in 'the system'.

He adds: "The penetration of the second pillar is about 53 per cent and, regarding the third pillar, we have to consider that there is no general statistic on how many people save for their old age pensions. But it is clear that the current third pillar model called Riester, which has reached a level of about 16 million contracts since 2002, is judged as not being sufficient by the German government."



There are also large differences, says Veh, in the prevalence of company pension schemes; 88 per cent of those at firms with at least 1,000 employees are entitled to a company pension. This falls to 48 per cent at firms with between 50 and 249 employees, and 29 per cent for those employed at firms with fewer than 10 members of staff.

Looking forward

Reforms, however, are on the horizon, with the Pension Level Stabilisation and General Capitalisation Act (Pension Package II) and the Company Pension Strengthening Act 2.0 (BRSG 2.0) in the pipeline, although neither of which are popular.

Pension Package II, wrote BNP Paribas earlier this year, "[…] aims to maintain the statutory pension benefit level (the Rentenniveau) at 48 per cent of the nation's average wage. To keep that level stable, the draft bill proposes the creation of a 'generational capital' fund that would pursue a globally diversified investment strategy". There were several measures proposed under Pension Package II. One of them was to raise the contribution rate from 18.6 per cent today to 20 per cent in 2028, then to 22.3 per cent from 2035 to 2045. Without implementation, the Federal Ministry of Labour and Social Affairs estimates that the average pension will soon be worth only 48 per cent of the average wage, falling to 45 per cent in the long term.

"Pension Package II is going in the wrong direction, in respect to the 48 per cent guarantee," says the Institute for Economic Research (IFO) Dresden's managing director, Prof. Dr. Joachim Ragnitz. "Other measures, such as the sovereign wealth fund, are ways to improve the system, but it will not help at all during the 2030s – the government expects that, in 2040, net dividends from the wealth fund will contribute 1.4 per cent to the total expenditures of the pension system."

BRSG 2.0 is another animal. That looks to strengthen the second pillar of Germany's pension system, examining contribution levels, different models, and the rates of payments and settlements. It is currently out for discussion amongst various associations and bodies, with some movement on it expected later this year.

Even so, it remains controversial for its lack of controversiality, with financial services giant Deloitte opining that it lacks a 'big breakthrough', despite being a step in the right direction.

"So far," says Karst, "it has to be stated that the BRSG 2.0 will not have the impact to raise dramatically the second-pillar penetration rates. And Pension Package II is considered as being a 'contract at the expense of the younger part of the German population', that could cause problems regarding the trust in the first-pillar system."

Even the sovereign wealth fund proposed under Pension Package II has its critics. The IFO wrote last September, in *The Equity Pension – How It Can Mitigate the Demographic Problem of German Pension Insurance*, that an investment of a manageable 0.5 per cent of GDP over the entire period of employment would lead to retirement income of €16,000 in today's prices.

It added: "Today's young generation could therefore benefit noticeably from a debt-financed equity pension. But it takes time for the income to accrue. And there are fluctuations in share prices that must be endured in the meantime."

"TODAY'S YOUNG GENERATION COULD THEREFORE BENEFIT NOTICEABLY FROM A DEBT-FINANCED EQUITY PENSION"

The situation in Germany is a messy one, with no clear solution apart from lowering the expectations for retirement, and the fuse is fizzing already – the ageing of a population pauses for no one.

"People somehow still have this idea that the first pillar should be enough," German Council of Economic Expert's chair, Prof. Dr. Monika Schnitzer, says. "This is not true; they have to save. The financial planning that people do is not sufficiently considering that they will grow old. But how can they do that if they earn too little? And it's a particular issue for women because this will not be enough if they are widowed, even more so if they are divorced."

She continues: "That is why we're so keen on pushing these reforms and why we're worried about the current plans of the government which benefits pensioners at the cost of the young generation."