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# Germany's pension time bomb

Without reforms, demographic shifts will push the system to its limits

If there's a single statement that remains indelibly associated with a German politician, it's former Labor Minister Norbert Blüm's 1986 declaration: "The pension is safe!" Once again, pensions are a hot topic of debate in Germany these days – and rightly so. Yet, what may have been a plausible assertion in Blüm's time no longer holds today. This is because the demographic structure of Germany's population has undergone a profound transformation over the past 40 years.

Germany experienced a sharp drop in birth rates as early as the 1970s – sooner than many other nations – and since then, women have given birth to an average of just 1.4 children each. As the large cohort of people born in the 1960s transitions into retirement, fewer young people are entering the workforce. Increasing numbers of retirees (along with people in need of healthcare and long-term care) now weigh on a shrinking pool of workers who finance Germany's pay-as-you-go system through their social contributions (see fig. 1). The Baby Boomers have essentially reneged on German "generational contract" by collectively having too few children. Each year, Germany's working-age population shrinks by about 1% solely due to demographic developments, even when assuming moderate immigration.

## Myopia and political timidity have brought us here

None of this should come as a surprise. Few trends are as predictable as demographics. Yet, as in many countries, the political class in Germany shies away from tackling this sensitive issue. Ratings agency S&P Global has simulated the potential future burdens for Germany, projecting that age-related costs (pensions, healthcare, and long-term care) will rise from under 20%

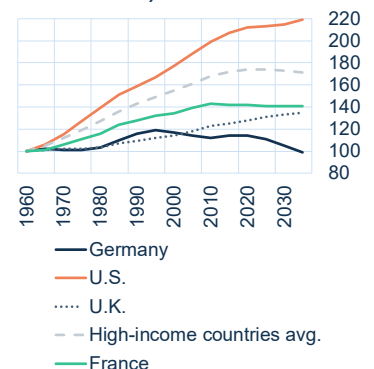
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## Pension system on shaky ground

Fig. 1: Working-age population (20-64 years, 1960=100)



Source: [United Nations](#), LBBW Research

of GDP today to more than 24% by 2060. Pensions would account for the largest increase. Compounding this challenge is the slowing economic growth potential due to Germany's intensifying shortage of skilled workers. This erodes the base of social contribution payments. Without corrective measures, Germany's credit rating could drop by two full categories – from AAA to A.

What options remain

Despite this evident peril, Germany's current coalition government – led by the conservatives (CDU/CSU) and the Social Democrats (SPD) – shows no ambition to reform pensions. Instead, the coalition agreement explicitly protects the status quo. Worse still, the government has exacerbated the problem by expanding pension benefits for mothers, which will add an additional €5 billion annually to the deficit. This paralysis becomes more understandable when you consider the political calculus: the coalition received 60% of the votes cast by those over the age of 60, but only 25% of the votes cast by those under 25 – the group that will ultimately bear the brunt of the costs. The strategy? Just leave the resolution for some future government.

One thing is clear: unless the volume of work performed – and thus the contributions to social systems – increases, the current model will become unviable in the foreseeable future. It's not just that the working-age population is shrinking; workers in Germany also clock fewer hours on average. Due to a high and increasing prevalence of part-time employment, Germany ranks lowest in the [OECD](#) for hours worked per employee, working 23% fewer hours per year than the average. Germany's not only running out of workers, those who remain are working less. While some might celebrate this as a success of economic prosperity, it won't close the pension system's growing financial gap.

Time to reconsider working longer

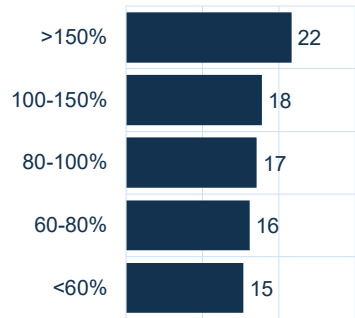
It's not unreasonable, therefore, to call for longer working lives. Whenever this suggestion is raised, critics invariably point to physically demanding jobs like construction workers. But for people like me, this wouldn't be unreasonable at all. Tying retirement age to average life expectancy of the general public, as currently the case, treats roofers (who engage in backbreaking labor) the same as chief economists (who, of course, work very hard as well – though differently). That's unfair. Low-income workers engaged in physically strenuous jobs end up receiving fewer years of retirement benefits for each year of contributions (see fig. 2).

The majority of service-sector jobs, by contrast, can easily be performed beyond the statutory retirement age. Departing from a uniform retirement age – which treats unequal situations equally – seems like a reasonable approach. Those who are capable of working longer should be encouraged to do so. Those who choose to retire earlier should accept reduced pension payouts. Instead, policymakers are allowing Germany to slide, eyes wide open, into a demographic trap.

Germany's credit rating in the balance

The government plans...: making things worse

Fig. 2: Life expectancy in years of 65-year-old men (right) by last income as % of the average (left)



Source: [DIW](#), LBBW Research

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