

Reform and Financing of Social Security Systems in Germany

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Structure

- Social Insurance in Germany
- Challenges
- Goals for future social security reforms
- Proposed solutions:
 - Capital Funding vs. Pay-as-you-go System
 - Citizens Insurance
 - Basic Income

History of social insurance in Germany

- 1883-1889: Social Insurance Acts by Bismarck (Chancellor of the Emperor William II.)
 - Health Insurance of workers (1883)
 - Accident-insurance (1884)
 - Pension and invalidity insurance (1889)
- Part of the “worker policy” („Arbeiterpolitik“) of the German Government
 - Anti-Socialist Law and Repressive Measures against the Labour Movement
 - Recovery and pacification of Workers
 - „Carrot and Stick“-Policy
- 1927 unemployment insurance
- 1957 major reform of the pension insurance
- 1962 social assistance

Principles of the German Social Insurance System

- **Centred on dependent employment**
 - Only dependent workers are covered
 - Financed with contributions on earnings from dependent employment
 - Benefits depend on previous contributions
- **Based on the model of a life-long-marriage with one male breadwinner**
 - Based on the bourgeois concept of family and marriage at the end of 19th century in Germany
 - Husband and wife are treated as one unit (also in the tax and the social assistance system)
 - no full own individual social security

Challenges

- **Change of Family Structures**
 - More singles, more single parents, more divorces
 - Emancipation of women
- **Changes in the Labour Market**
 - More self-employed
 - More part-time employment
 - More job changes
 - More interruptions
- **Poverty and unequal distribution**
 - Increasing number with relative income poverty
 - Shrinking middle class
- **Growing significance of income from assets**
- **Demographic development ('double aging')**
 - Birth reductions
 - Increasing longevity

Demographic Development and Health

Do Health Costs increase?

- **Medicalisation thesis: yes**
 - older people are more expensive
 - technological progress will increase costs *and* longevity
 - we will live longer and more unhealthy
 - **Compression thesis: no**
 - most of the costs are close to death
 - Not old age is expensive, but death, which is independent from longevity
 - Technological progress will lead to a longer and more healthy life
 - Costs might even decrease
- Empirical studies: not clear, which theory is more appropriate

Demographic Development and Pensions

- Double Aging → elderly-dependency-ration will increase
 - This ratio is only one factor that effects the pension system
 - The return of a pay-as-you-go system is the growth rate of the sum of national wages:
$$1 + i = (1 + g) \cdot (1 + n) \Leftrightarrow i \approx g + n$$
 - i : return of the pay-as-you-go system
 - g : growth rate of total earnings (income)
 - n : growth rate of population (group of contribution payers)
- If growth rate is high enough it can fully compensate the effect of a shrinking population**

Demographic Development and Pensions

- Factors that might compensate the effect of demographic development on pensions:
 - Growth of productivity
 - Higher retirement age
 - Higher employment rate
 - Immigration
 - Extension of pension insurance to other groups
 - Extension of the financing base to other income sources

Demographic Development and Pensions

- Nevertheless:
 - increasing contributions or decreasing level of pensions expected
- **Reaction of policy in Germany**
 - focus on stabilisation of contributions
- **Lead to other problems:**
 - Statutory pension alone will no longer be sufficient to maintain the standard of living in old age
 - (probably) increasing old age poverty in Germany
- **Consequences**
 - Private capital funded pension as supplement
 - Current discussion about minimum pensions

Goals for social security reforms

- 1. Financing on a broader basis (incl. capital income)**
- 2. Universal Social Security for the whole population**
- 3. Individualisation of Benefits**
- 4. Minimum Benefits**

Discussion of three proposed solutions

1. Capital funded versus pay-as-you-go system
2. Citizens' Insurance
3. Basic Income

Funded system instead of pay-as-you-go

Pro

- Assertion: “Not susceptible to demographic development”
- National capital might increase
- (Perhaps) higher Return than the pay-as-you-go system

Contra

- Higher return is not clear
- Much higher risks under funded system
- Pay-as-you-go is more flexible due to major shocks

Conclusion

- **Basic Security** (incl. guaranteeing a certain level of living standard) should be provided **by a pay-as-you-go system**
- **Funded system** could be used, if ever, **for additional surplus**

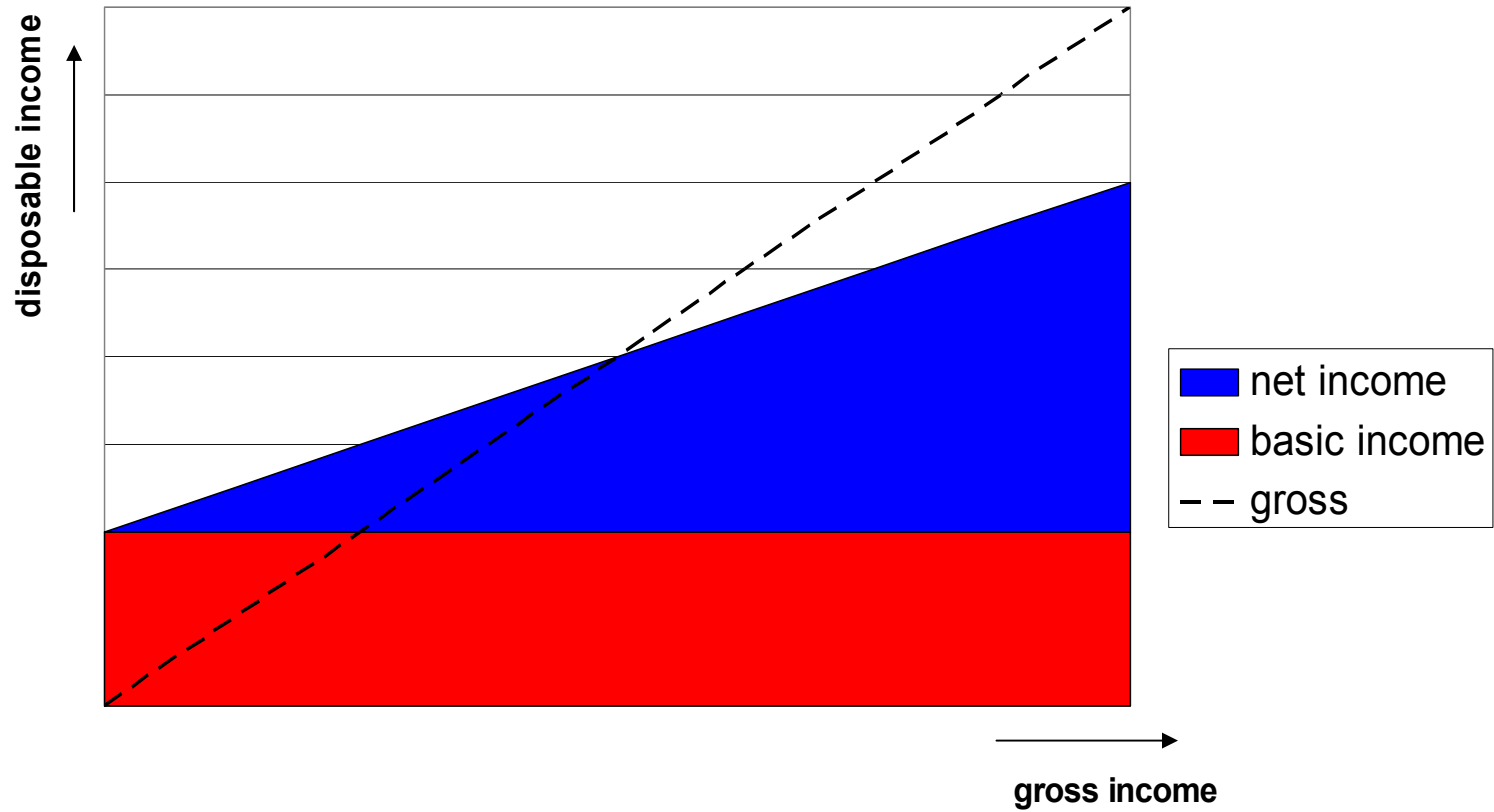
Citizens Insurance

- Health insurance and pensions
- **German social insurance:**
 - finance is based only on earnings
 - only dependent workers are covered
- **Citizen insurance**
 - all persons are covered
 - contributions must be paid on all income sources
- **Advantages**
 - **more social justice** (horizontally and vertically)
 - high **contribution rates** in Germany would **fall**
 - **financing is more stable** (within business cycles as well as in the long run)

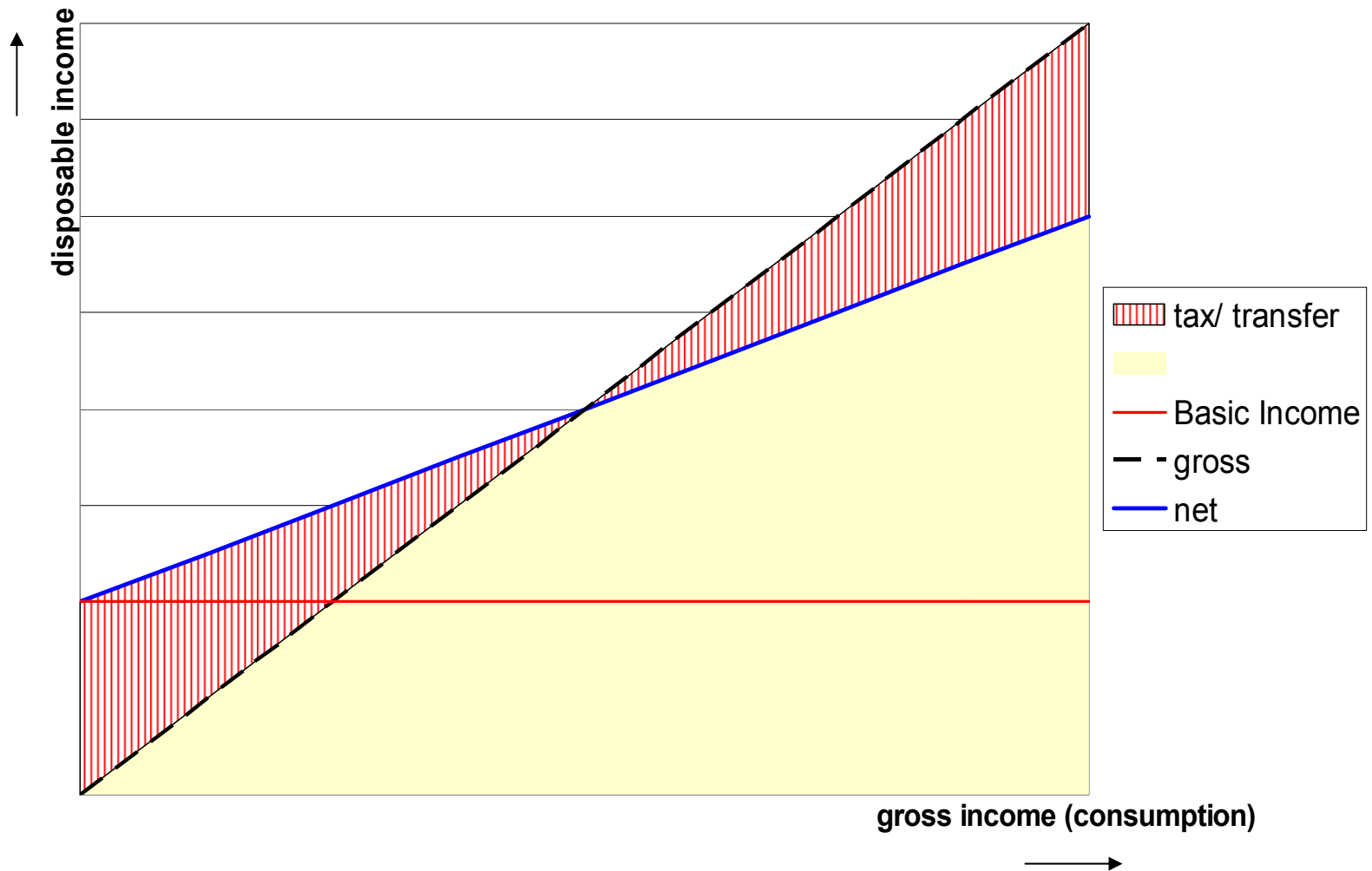
Basic Income

- A **Basic Income** is an income that is **regularly paid** by the state **to all members** of a society **on individual basis**
- It is not an additional income for everyone, but a kind of **advance payment** that ensures that every one could make ends meet
- The basic income will be **integrated in the tax system** and replace most of the tax allowances
- **Basic Income/ Flat Tax proposal:**
 - Everyone will receive the basic income
 - Income taxes are paid on each income with only one tax rate
 - **Disp. Income = Basic Income + (1-t)·Gross Income**
(with t: tax rate)

Basic Income Flat Tax



Redistributional Effect of a Basic Income



Advantages of a Basic Income

- **Simple implementation**
 - Everyone will receive a minimum income without a complicated means test (no hidden poverty)
 - Simple tax system: only one tax rate which is identical for each income source
- (Income) **poverty can be eliminated**
- High **redistribution**
- Strengthening **social cohesion and solidarity**
- Higher **incentives to work** (compared to social assistance)
- **Reduction of economic risk** → higher productivity
- Promotion of **innovativeness and creativity**

**Thank you
for your attention!**