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Crisis in Germany's pension fund, as unemployment rises

by William Engdahl

A just completed, detailed *EIR* study of Germany's pension system reveals that the present economic and fiscal policy of the German federal government is not only flawed; it is on a catastrophic course, one blindly based on economic axioms of the postwar Bretton Woods liberal "free market" world, whose basis in economic reality has collapsed. The results of the *EIR* study demand the attention of policymakers well beyond Germany, not only because analogous patterns of misuse of the labor force are confronting other industrialized countries, even those with a very different pension structure; but also, and above all, because the strength of the German economy is the keystone to any hope for a European, and hence, worldwide industrial recovery. If Germany—the natural trading partner for Russia and other nations emerging out of the old Soviet bloc—sinks further into depression, every nation will soon find itself in economic and strategic quicksand.

On March 6, the German Federal Labor Agency announced the highest unemployment since 1945: As of the end of February, 4.3 million Germans were officially unemployed. This was a jump of 443,000 over the previous year, representing an alarming 11.1% level of unemployment.

What no one in Bonn dared to say, was that this itself represents a gross falsification of the reality. In actuality, German unemployment today stands at nearly 5.8 million citizens. This does not count those working short weeks or in job training, as a form of hidden unemployment. (A 6 million jobless level was last seen just before the Nazi seizure of power in 1933.)

The difference, 1,505,062 jobs, represents what the Bonn government has willfully chosen to hide from the public statistics, by pushing people into early retirement, in order to minimize the cost to the State budget, as well as to politically understate the actual dimension of the present jobs crisis. Since 1990, to conceal this unemployment reality from the public, the unemployed have been increasingly pushed onto what is officially termed "Old Age Pension Due to Unemployment."

The consequences of shifting 1.5 million working people out of the productive workforce and onto the State pension system, have been deliberately ignored until recently, as the entire fabric of the once-esteemed German social welfare model is ripped apart by the demands of the European Union's Maastricht Treaty, and by political actions which are arguably, if not strictly a criminal violation, at the very least, a violation of the German Federal Constitution.

Yet, as *EIR*'s investigation shows, the present debate on the future of the German social system, especially of the future financing of the German pension system, is being conducted by the Bonn government on a fundamentally dishonest basis.

Pressure points in the pension system

Germany has traditionally been proud to point out that it was the first industrial nation in the world to establish a State pension system. The present State Retirement Insurance System (GRV) has been reformed only three times since it was created under Otto von Bismarck in 1891.

The last reform, the Pension Reform Law of 1992, was undertaken in the midst of the process of German reunification. The essence of the German State pension system is what is called "pay-as-you-go," often referred to in the public debate as based on a *Generationsvertrag,* a contract between the generation reaching retirement age and the generation now working. In "pay-as-you-go," a tax on the working peo-

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ple insured in one year, goes to pay the pension of those retired that year. The idea is that when those now working retire in, say, 20-30 years, they will get a similar benefit.

There are several pressure points in the system. If the total number of people employed falls, or their average income falls, the social security payments of those remaining employed must be raised to maintain the same pension benefits, or yet a new group not yet insured must be compelled to join the system and pay their social security tax. Under pay-as-you-go, if the population and young workforce are growing relative to the number of retirees, the burden of financing the pension tax is relatively light and can even fall. In the opposite case, declining working-age population, the relative burden increases. Today the German pension system is under pressure from all these aspects.

Various politicians are prone to talk about the "demographic crisis," in which the number of retirees by the year 2010 will increase dramatically, as the number of people in the workforce will shrink. Projections prepared by various demographers indeed support this, on the surface. But the present crisis of the State Pension Insurance System in Germany is, surprisingly, not this demographic crisis.

The present form of the retirement insurance model took place in the "Pension Reform of 1957," during the administration of Chancellor Konrad Adenauer. Its original concept was based on a study, "Social Security in Industrial Society," by economist Wilfrid Schreiber. Schreiber argued that modern industrial society had changed the family structure such that no longer could young working parents provide for the permanent care of older citizens, as well as their own growing family, and that a social or State concern was legitimate. Schreiber's plan, however, called for public support, not only to the elderly no longer working, but to young people not yet able to work, his so-called "Three Generation" contract.

The idea was to encourage stable family formation via income support to families having children as well as supporting pensioners, to foster healthy demographic growth. The 1957 reform, though, took only one part, perhaps on the reasoning that the growing number of retirees could be won permanently to Adenauer's party, the Christian Democratic Union. The "dynamic pension," which overnight raised the pension from earlier tiny sums of 25% of average income to 70%, was begun on Jan. 1, 1957. Adenauer's comment upon dropping the third part, that of the young generation—"people always have babies"—proved drastically wrong after 1966, for a complex of reasons. But the economic factor of growing costs on young families, increasingly forcing both spouses to work full-time to meet their expenses, was not reckoned in the boom years of the late 1950s. Family formation began a steady decline since the late 1960s, with serious implications for the solvency of the pay-as-you-go pension fund system.

Ironically, one reason it took until the late 1980s for the demographic problem to become the basis of a thorough reform debate, was the fortunate fact that during the 1950s and

A homeless man in Augsburg, Germany. Germany's pension system has, since the postwar years of Chancellor Adenauer, provided the elderly with a secure retirement; this is now in jeopardy, because of the Maastricht Treaty's vicious austerity demands.

1960s, the inflow of millions of young families, often with high skill levels, into the West German labor force from the East, gave a huge "demographic" boost to the pension fund. Again, today, when demagogic politicians are trying to win votes by calling for a ban on refugees, claiming the social costs are too much for the State, this ignores the reality that since 1990, the inflow of some 1.5 million such refugees from the former Soviet Union and elsewhere, has consisted mostly of young families, whose active participation in the workforce, often in difficult-to-fill jobs, makes a significant compensation for demographic pressures on the pension system. Indeed, Germany should hang a sign, "Young Immigrants Welcome!" on its borders.

In 1992, the reform which was passed, after years of discussion, basically corrected for the alarming decline of birth rates which began around 1966. Under the 1992 reform, the pension fund system shifted from a calculation based on "gross wages," over to "net wages after tax." That is, after 1992, the pension paid when one retired would be calculated on a person's after-tax or net income. But the calculation of

what tax he should pay into the system would be calculated on his gross wage. Today, net income is only about half the gross sum, so the difference is significant. This change was based on the argument that it would relieve the demographic pressure until 2030 or so.

Last year, a follow-up study to evaluate the 1992 reform was commissioned by the Association of German Retirement Insurers (VDR), from Prognos AG of Basel, the institute which prepared the actuarial and demographic studies used in the 1992 reform. The 1995 Prognos study "reaffirmed the policy of the 1992 Reform. The system's demographic problem is solvable, without having to go in the direction of a minimum pension." The report found "no acute need for new measures in the State Pension Insurance System." It pointed out that the total population figure is far less important than the number of persons employed, for the future solvency of the retirement insurance system.

Maastricht, a job killer

Yet, less than one year after Prognos issued its report, the solvency of the German pension system has become "issue no. 1" in a debate over costs. Why?

Because of disastrously wrong economic and monetary policies of the federal government and the Bundesbank, there has been a catastrophic change in the solvency of the State Pension Insurance System. One of the least appreciated factors in this has been the poorly understood "Maastricht process."

Since early 1992, the Bonn government, together with the Bundesbank, have begun a strict policy of budget or spending reduction, tax increases, and severely restrictive monetary policies, all aimed to meet the four "convergence criteria" defined in the December 1991 Maastricht Treaty on European Monetary Union.

Never in the history of Europe have 15 nations simultaneously and willingly undertaken to impose such drastic fiscal and monetary austerity. The result has been a vastly inflated deutschemark, which has penalized German export companies harshly. To maintain market share, large companies have been forced to slash costs to the bone, by dumping workers in the hundreds of thousands onto unemployment or "early pension." DASA, Bremer Vulkan, and other companies are only the beginning. To cut the deficit and public debt to Maastricht targets by 1997, the federal, state, and local governments are all laying off employees in the thousands, aggravating the crisis of the pension system along with it. The city of Stuttgart alone just cancelled public infrastructure projects which cost 20,000 skilled jobs.

German companies are fleeing Germany, building new plants in the east, in France, in the United Kingdom, in cheap-wage areas of Asia, or even in the United States. In 1995, German companies invested a record DM 52 billion (about $35 billion) abroad in new workplaces that formerly would have been built inside Germany, double the record level of 1994. This wholesale permanent export of jobs brings a permanent loss to the pension fund system of economically active premium contributors.

One of the major effects of this "globalization" of German companies in the past 4-5 years, has been the effort to hide the real level of unemployment through a back-door device called Old-Age Pension Due to Unemployment, or the so-called forced pension. Companies save the cost of paying their 50% share of the mandatory contribution for nursing home care for each worker or employee he can put into early retirement. The combined costs of the three, for both employer and employed today, are 40.2% of gross salary.

As the Maastricht-imposed austerity has forced the German economy into deeper crisis in the past three years, the number of those on early retirement has exploded. It remained at some 55,000 yearly in 1990-92. Beginning in 1993, it doubled to 112,000; in 1994, it doubled again to 203,000; and in 1995, a 50% further rise to 290,000. According to estimates of the VDR, by the end of this year, another 736,000 new early retirees, who had filed before the proposed law changes of this past month, will be entered in the pension system.

But these 1,505,062 formerly employed are now no longer supporting the pension and other State insurance funds with their contributions, but rather are taking from the fund. This is an immense new burden which was not evident when the Prognos calculations were made.

Other 'obligations'

This brings in the highly complex and poorly understood subject of so-called Non-Insurance-Related Benefits, obligations not related to the State insurance, but paid by the various insurance funds. This is above all a political problem, which has deliberately been obscured by the government, for reasons which shall become obvious. A recent study by the VDR on the problem, calculated a combined retirement, health, and unemployment insurance sum of DM 170 billion in 1995, of so-called non-insurance obligations. This amount must be compensated outside the income flow of the present State insurance system. Of the sum, the federal government, whose budget tricks created the gaping deficit, only repaid DM 70 billion via "Federal Contribution" transfers from the general budget. What about the remaining DM 100 billion?

This must be paid by increasing the contribution burden on the economically active, through higher contributions for employer and employed. The largest part of the combined Non-Insurance-Related Benefits, some DM 48 billion in 1995, comes from the State Pension Fund.

The State Pension Insurance System has no independent supervisory body to oversee how it is run; it comes under the "custodial" oversight of Theo Waigel's Finance Ministry. Responding to the growing pressures to meet Maastricht deficit quotas, amid a collapsing tax revenue base and economic depression, the federal government has quietly allowed the "non-insurance obligations" not covered by federal bud-

get contribution, to explode. Its consequences are "off-budget," and not thus part of Maastricht. It hits, instead, employers and employed.

What are these "obligations"? Today, on average, 33-35% of the total annual pension contributions of DM 320 (1995) went to non-insurance obligations. Of that, at least 15% remained to be covered in future employer and employed contribution increases.

Some of the obligations, it can be argued, are indirectly aiding the future solvency of the pension system, by providing contribution payment for an employed mother's "baby years," or time spent in education after age 16 to learn a trade or profession. But payment from the State Pension Fund also goes to compensate military and alternative civilian service time. A large share of payment costs put on the Pension Fund go to compensate for the large number of citizens from the former East Germany, who had paid into the bankrupt State Pension System there, and whose obligation was assumed by Bonn after July 1990.

The list of the non-insurance obligations is long and debatable. But since 1990, a growing portion of them have been directly related to forced early retirement, as a form of hidden unemployment, where an early pensioner has not paid his full working years into the system before drawing from it. Or where so-called "unemployable" persons are forced into retirement, years before retirement age. They do not count as "officially unemployed."

Each 100,000 new early retirees adds a cost to the Pension Fund of DM 12.7 billion. The pending 736,000 new early pension applicants will increase the future costs to the Pension Fund by an added DM 94 billion. This exploding cost factor, not demographic miscalculations, is why, sometime later this year, Bonn will announce the "urgent" need to raise the Pension Insurance Contribution to well above 20% of gross salary, from today's 19.2%.

Many of the so-called non-insurance obligations are indeed things the State is obligated by law to support, and should. But the sly practice of hiding these from the State budget, by dumping them onto the Pension Fund, has increased drastically since 1990. From 1980 to 1990, a decade of recession and growing unemployment, a total of some DM 389 billion non-insurance obligations was put onto the burden of employers and employees to be covered from the pension system. More than one employer has termed this a "job-killer."

Since 1990 and German unification, during which time Bonn has concealed significant costs of unification in this "clever" way, another DM 194 billion has been added, creating a combined non-insurance obligation not covered by any Federal Budget Contribution, of DM 583 billion from 1980 to 1995. Not surprisingly, the earlier practice of maintaining an emergency retirement minimum reserve of two years' Pension Insurance Contribution, to provide a buffer against economic recession periods, has disappeared. First it was quietly cut to one year's reserve, then to two months, then one month, and today it is zero!

A way out

Now, politicians desperate to cover the crisis of years of fundamentally wrong economic policy and jobs policy, have begun to call for eliminating these non-insurance obligations, raising income taxes to cover their costs, and shifting the various items onto the regular budget. On March 8, the government was forced to deny a charge by Social Democratic social expert Rudolf Dressler, who charged that the Bonn government had already finalized plans for drastic austerity in the State Pension Insurance System (to be made public after the March 24 elections, of course). The austerity package reportedly includes severe cuts in payment of non-insurance obligations, such as payment for job training from the current seven years to three years; cuts in paid on-the-job-training time; cuts in allowed health treatments for pensioners; and a raising of the age limit for women and severely handicapped from the current 60 years to 65. As well, a cut in benefits to widows from now DM 1,220 monthly, to DM 600.

If this is accurate, it represents a further step on the road to catastrophe, every bit as destructive as the 1931 austerity program of the Brüning government. The only way short of such economic catastrophe, is to change the axioms of the entire postwar liberal free market, to return to a concept of productive credit generation by the State for real job creation. This could be done, in building, initially, the desperately needed economic infrastructure of Europe and Eurasia, east to China.

Today, each added 100,000 unemployed adds a direct State cost of DM 5 billion (in the 1980s it had been estimated at DM 3 billion). Were the federal government to issue long-term "development bonds," say, in an annual sum of DM 100 billion, earmarked for specific high-speed rail, port, canal, and energy infrastructure development of the underdeveloped eastern part of Eurasia, far from being an added "cost" of DM 100 billion on the deficit, it would lay the basis for the greatest sustained economic boom of this century into the next.

Studies by North American Rockwell Co. during the 1970s showed that for every dollar of government spending on high-technology infrastructure, the State was repaid at least $4.50 in increased tax revenue from a wealth of new employment and industry which came, as a result of the space exploration effort. So, too, with advanced transport infrastructure. Instead of German policy under today's Maastricht straitjacket being a force for job killing, with such a productive credit strategy by the federal government, spending of DM 100 billion could bring the federal budget an added tax income of at least DM 450 billion annually! This is the only solution to the present catastrophe of the German retirement insurance system, short of a willful return to the policies of the early 1930s.