



# How to overcome loss aversion and pave the way for pension reforms in Germany?



**Germany's public pension system faces mounting pressure as demographic change strains its pay-as-you-go structure. This article by Ruth Schüler, an economist at the German Economic Institute, examines why pension reform remains politically elusive despite its urgency – and what it would take to build public support for the difficult choices ahead.**

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The German public pension system is under enormous pressure to reform due to demographic change. As the public insurance system is organized as a pay-as-you-go system, today's contributors need to finance the pensions of current pensioners. The system is the prototype of a Bismarckian regime where contributions are converted into points and determine future pension entitlements. Redistributive elements exist for specific life events. With an ageing population fewer contributors have to cover pensions for a rising number of pensioners. The last reforms aimed at ensuring the financial sustainability of the pension system, such as raising the standard retirement age and introducing a subsidized private pension plan, date back two decades.

The favorable economic development after the financial crisis of 2008/09 led to a departure from the sustainable path that Germany had been embarked upon in the early 2000s. With the ageing of society and therefore of the electorate, the policy was altered by the introduction of non-deductible early retirement for particularly long-serving employees, the so-called 'retirement at 63' as well as the mothers' pension and the double stabilization lines. While the introduction of the subsidized private pension plan – known as the 'Riester-Rente' – has increased the engagement in the third pillar, and occupational pension schemes complement retirement saving for parts of the German population, the first pillar remains the main pillar for old-age provision in Germany as of today. Even though the need for adapting the system and paving a demographically sustainable path are acknowledged, reform options are widely opposed by the public.

In addition to the general resistance to reform, the pay-as-you-go nature of the public pension system implies an intergenerational contract between the younger generation contributing to the system and the older generation receiving benefits through the system. Policy makers in Germany therefore face the challenge of reforming the system while maintaining trust in the statutory pension scheme. The German system has three adjustment mechanisms that can be used to control the financial viability of the system:

- **Increasing the contribution rate;**
- **Lowering the pension level;**
- **Raising the retirement age.**

Even though the pressure to reform is high, none of these reform options finds a majority in the German population. To identify a reform option for the German pension system that has a realistic chance of being implemented within the German political system, it is important to understand the attitude of the German population towards these three mechanisms. This involves clearly explaining the interrelationship between these three mechanisms and the consequences of inaction, encouraging the public to weigh the three options, and giving each reform option a measurable dimension. This was done by implementing a Factorial Survey Experiment as part of a population survey by the German Economic Institute (IW) in 2023. In this experiment, the three stated adjustment mechanisms are presented to the respondents jointly in different reform bundles. Each respondent rates nine different reform bundles with each bundle combining different levels for each adjustment mechanism. Thereby, the adjustment mechanisms are examined in relation to each other and potential reform adjustments are simulated. This allows exploring which mechanisms meet with the least resistance.

## IT IS IMPORTANT TO UNDERSTAND THE ATTITUDE OF THE GERMAN POPULATION TOWARDS THESE THREE MECHANISMS

The results indicate a very strong status quo bias: even the explicit presentation of reform scenarios is unable to overcome the existing aversion to reform. Respondents express a low willingness to compromise for the sake of a sustainably financed pension system. In doing so, respondents ignore the consequences of inaction or accept them. Keeping the status quo would only be financially feasible by increasing tax subsidies, which would place a considerable burden on the state budget. The design of the experiment leaves unanswered whether respondents are fully aware of the consequences of inaction.

In a direct comparison of reform options, an increase in contribution rates is opposed the least. Pension cuts are seen as the most painful. Delaying retirement by one year is viewed as negatively as an increase in the contribution rate of around three percentage points or a reduction in pension levels of around 4 per cent. By rating the contribution rate as the most accepted – or rather the least objected –

adjustment mechanism, respondents delegate parts of the costs of the reform to companies as the contribution rate in the German public pension system is financed equally between employees and employers. The consequences of a higher contribution rate for employers, namely an increase in labor costs possibly leading to negative employment effects and reduced investment activity, are not made explicit in the experiment. It therefore remains an open question whether respondents take these far-reaching implications into account.

The lowest acceptance of reforms was to be found among those whom they would least affect: the over-50-year-olds. Consequently, objection is much weaker among those under the age of 50. At the same time, this group is the most concerned about their pension and the part of the population that will be most affected by the consequences of reform or the lack thereof.

Given the electoral weight and the conservative attitude concerning pension reforms of the over-50-year-olds, the group should be targeted specifically when it comes to highlighting the consequences of inaction for the society. Failure to act would either require a greater commitment to occupational and private pension provision or, while guaranteeing a constant level of pensions, lead to an immense burden on the state budget. Delaying the reform further risks reinforcing the public's expectation of a constant pension level without having to contribute, thereby reducing the scope for manoeuvre and intensifying the debate on pensions. ■