Funded German pension systems will be 'beneficial'

Mark Cobley and Johanna Symmons
10 Jul 2008

The German state of Lower Saxony has said it will introduce a new fund to back the pensions promises made to its civil servants, becoming the latest in a series of German states to do so. A new academic study has been published this week, recommending the idea and calling for such funds to invest in stocks and real estate, as well as the traditional fixed income.

Lower Saxony, or Niedersachsen, will begin to pay into a new fund for every new employee that joins from 2010, according to a spokesman. Other states that have also taken this step include Rhineland-Palatinate, in 1996, and Saxony, in 2005.

The academics behind the study - Raimond Maurer and Ralph Rogalla of Goethe University in Frankfurt-am-Main and Olivia Mitchell of the Wharton School in Pennsylvania - said progress is being made towards a funded system in Germany.

At present some public schemes in Germany are unfunded or "pay as you go" - which means the payment promises to future pensioners are not backed by a pool of investment capital. They face a rising bill, since rising life expectancy means that an ever-larger number of retirees will be supported by a shrinking pool of taxpayers.

The German central bank has also set up a new fund to back the pensions of newly-hired federal civil servants. The German private sector is also moving in a similar direction. In 2006 the German utility group Eon paid €5bn ($7.9bn) to pre-fund part of its pension liabilities.

The academics recommended that where such a fund or funds are set up, a conservative, bond-heavy investment strategy - which is common among German schemes - is not the best option.

They said: "We identify an investment strategy for plan assets that will minimise worst-case pension costs; this turns out to be 22% in equities, 47% in bonds, and 30% in real estate."

The study also echoes calls from a UK economist who has proposed a similar scheme to address £1 trillion (€1.3 trillion) worth of unfunded public-sector retirement debt in the UK.

In the private sector, especially in countries such as the UK and the Netherlands, the norm is for pensions promises to be backed up with funds. Some public pensions are like this too, such as local authority schemes in the UK, or the national civil service scheme in the Netherlands, which is backed by the €220bn fund ABP.

The advantage of a funded scheme is that contributions are paid into a central pot, which can then be invested in growth assets, such as stocks or bonds. This should mean fewer contributions from the employer are needed to make the same benefits payments.

The UK government's latest estimate of its unfunded liability - compiled by Neil Record of the UK's Institute of Economic Affairs, is £875bn. Record looked at the accounts of the four principal public schemes: the National Health Service, the Army, teachers, and civil servants. He believes this is an underestimate as it does not use the most up to date accounting standards.

Record, who is also chief executive of Record Currency Management, would like to see the liability "monetarised" through the issuance of index-linked gilts to a new government agency.

He said: "This is an issue that needs to be addressed at some point. You can pretend the world is the way you want it to be, but this debt will come home to roost."

Read the academics' paper

Click here
Web link

Article tags:
Asset Management | Germany | Neil Record | Olivia Mitchell | Pensions | Raimond Maurer | Ralph Rogalla

Printer friendly version Email to friend Comment on this article

Related articles

- **Germany to launch scheme for government workers** 21 Sep 2007
- **EU may require national deficits disclosure** 15 Jun 2007
- **Reports on the death of final salary schemes are exaggerated** 23 Apr 2007
- **Royal Mail sets pension precedent** 19 Feb 2007

Other articles from this Section