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A Case Study

The looting of pensions: destruction of the 'German model'

by William Engdahl

In recent months, one government after another across the industrialized world has taken drastic steps to alter the public pension system, the very basis of social stability established in the depths of world economic depression some six decades ago.

In Britain, the heart of the Anglo-Saxon "free-market" ideology of the past two decades, both Labour and Conservatives are discussing "privatization" of the 1948 national pension scheme. The Institute of Economic Affairs, a think-tank whose members strongly influence the John Major government's policy, recently called for an immediate end to the state pension system.

"Governments of the main European countries are accepting that they will be unable to provide the state pensions they have long promised their people. . . . The system of national insurance for pensions income in retirement is belatedly drawing to its close," the IEA's Arthur Seldon declared. The state pension model must be replaced with "flexible private pensions and other forms of saving. . . . The market must be allowed to devise new methods." British media report that the Labour Party of Tony Blair is in basic agreement with this call for privatization of public pensions.

In the United States, the Congress and the White House have begun a debate over a highly controversial proposal by a Presidential Commission on Social Security Reform. The commission urges that the present Social Security Trust Fund be, all or in part, "privatized." Since the trust fund was reorganized in 1983, it has been accumulating a growing annual surplus, as baby-boomers pay in more than present retirees take out in pensions. The commission proposes that this surplus be at least partly diverted from investing in U.S. Treasury bonds, to "earn" more profit in the booming stock market. Not surprisingly, Wall Street investment banks have been heavy backers of the privatization schemes. They would gain huge profits from controlling those funds, which now, by law, must be invested in U.S. government securities. In 1996, American taxpayers paid in a surplus of some $165 billion to the fund, whose total is now $500 billion. By 2012, the cumulative fund surplus is calculated to reach some $3 trillion. Such proposals for Social Security privatization are a brazen move to grab more liquidity to pump up the world's greatest speculative bubble, the $9 trillion U.S. stock market.

In Japan, where the Ministry of Finance holds an iron grip on the government's $1 trillion public pension fund, the new Hashimoto government has called for reform of the entire pension system, to allow it to earn more by investing in private areas. In France, the Juppé government has recently introduced legislation which would allow 14 million private sector employees to contribute a portion of their income to privately run pension funds, which will invest the money in stocks or bonds, drastically weakening the public pension contribution system.

Almost daily, one after another proposal for dramatic reform or abolition of the existing pension systems of the Organization for Economic Cooperation and Development industrial countries are being made. The OECD has just issued a study of pension systems in its member countries, which calls for "reduced spending on pensions by government compensated by a stronger private role." The International Monetary Fund has just published a paper on the pension systems of the Group of Seven and other industrial countries, which concludes that to avoid a major funding crisis in the next century, governments in many countries must "reduce the excessive generosity" of present pension systems.

The fraudulent pension debate

Nowhere is the controversy over the future stability of public pension systems more intense than in Germany. And nowhere has the government been more brazen in its manipulation of the fears and justifiable anxieties of its population.

Just one year ago, Labor Minister Norbert Blum was adamant that the German Public Pension system was sound, and that no "contribution tax" increase above the 19.2% of an employee's gross wage level was needed. Quietly, after regional elections had passed, Blum announced an increase to 20.3%, as of Jan. 1, 1997.

Now, after a cynical phony debate, which portrayed Blum as the champion of the pensioners past and future, against ruthless, tax-hungry Finance Minister Theo Waigel, who proposed a large tax on pension payments, it seems all but certain

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that the most significant slashing of pension benefits and increase of contribution demands since the 1891 founding of the German pension system, will become law.

The latest Blum "reform" is the result of a commission set up by Blum last June, with a mandate to propose how to finance Social Security Retirement obligations of the population into the next century, in the face of dramatic demographic changes, in order to "secure the contract between generations," that is, the financing by the generation at work today of their elders in retirement.

The Blum Commission was made up of a mix of private and government interests, including the adviser to the Finance Ministry, Rolf Peffekoven; Deutsche Bank management consultant Roland Berger; Meinhard Miegel, of the Institute for Economics and Society; former Finance Minister Hans Matthoefer; and representatives of the Association of German Social Security recipients and the National Insurance Agency for Employees. Otmar Issing of the Bundesbank was a guest participant.

Three weeks ago the commission presented its proposal. The upshot is that Germans covered under the Social Security Retirement system will pay much more Social Security Tax, from 19.2% last year, up to 22.9% into the next century. At the same time, the pension they will receive will be cut drastically, from 70% of a worker's final net salary or wage, at retirement, down to 63%, a 10% reduction in benefits. To further cut costs, benefits for working people forced to retire because of work-related disability will be slashed by half. In addition, the plan proposes a new fund, to be controlled by Waigel's Finance Ministry, the "Family Savings Fund," which is to take revenue from a new tax that will bring in DM 17 billion ($10 billion) annually. Ostensibly, this fund will build a surplus beginning now, in order to finance the retirement of baby-boomers in 15 years or so.

The crisis is in economic policy

The argument made by Blum is that dramatic demographic changes—people live longer, and younger Germans have many fewer children today—make equally dramatic measures urgent. This is not true.

There is today no fundamental crisis in the German Social Security system, and, above all, no crisis in the demographic assumptions it contains. The crisis is in the Bonn government's economic policies, especially since German unification and the 1992 Maastricht Treaty on European Monetary Union dictated serious changes in government finances and policy.

The last major reform of the Social Security system took place in 1992. At that point, based on the argument of changing demographics, the rate of contributions was significantly increased and the rate of calculating a worker's pension was changed from 70% of his gross last wage, to 70% of his "net" after-tax wage, a significant reduction. According to SPD social expert Rudolf Dressler, that 1992 reform will secure the financing of Social Security Retirement benefits at the 70% level "until the year 2030. Until then there is no reason for any fundamental change of the present system."

As recently as January 1995, the German Association of Pension Insurance Policyholders, released a thorough study it had commissioned from the consulting firm Prognos AG, the group which had prepared the demographic and cost estimates in 1987 for the 1992 Social Security reform legislation. The mandate was to see how the 1992 reform was working and whether any major changes were required. The study concluded that, indeed, the system was solvent and that no major changes were needed. It stated that the demographic problem was solvable within the present system, and that no major new system was required. That situation has not altered in any major way in the past two years.

Why, then, such an attack on the very foundation of the state's pension system? Here we must look behind the curtain to see the government's catastrophic economic policy. The pension funds are being secretly looted to cover gaping and growing budget deficits, largely in order for Germany to be able to claim a 3% public deficit, a prerequisite for joining the European single currency by 1999.

The Finance Ministry's tax fraud

While the eyes of the nation have been riveted on the trial of Peter Graf, father of the world tennis star, by the government for tax fraud, the greatest tax fraud in German history continues to this day largely ignored. This is the stealing of up to 30% of the annual Social Security Tax contributions of employees and employers by the German Ministry of Finance, under the legal loophole category of expenses for *versicherungsfremde Leistungen,* or, expenses unrelated to Social Security Retirement benefits (described below). Waigel's office refuses to divulge exact figures on the total annual sum involved, but private informed estimates indicate the size is staggering, as we shall see.

According to another study by the German Association of Pension Insurance Policyholders in 1995, this is an entirely political problem, massive in scope, and deliberately concealed from the public by the government. According to the study, the combined sum for Social Security Retirement, Medicare, and Unemployment Insurance diverted into the category *versicherungsfremde Leistungen,* amounts to DM 170 billion ($100 billion) per year.

This DM 170 billion gap must be covered, in order to maintain even the static level of mandated benefits in the state Social Security obligations. The federal government, which caused the diversion of allocated funds of DM 170 billion, however, according to the study, compensates the various Social Security and other funds via a so-called "government contribution," by only DM 70 billion per year. This means that some DM 100 billion per year must be paid by someone other than the state, to maintain the present Social Security system. For the Social Security system alone, according to

Germany is about to implement the most significant slashing of benefits and increase in contributions since the 1891 founding of the pension, or Social Security, system. The problem is not caused by dramatic demographic changes, but the government's bad economic policies and looting of the pension system. Here, a German pensioner cares for a child; they are both paying for such policy mistakes.

estimates of *Der Spiegel* magazine, this deficit not covered by Waigel's Finance Ministry in 1996 was DM 57.5 billion. And, as unemployment grows, the deficit grows with it.

Who pays? Employees and companies in Germany, through 50-50 payment of a higher Social Security Tax. Why does Waigel's ministry carry out such manipulations? Because it forces the cost off the balance sheet of the federal budget (good for Maastricht goals), onto the private sector. But seven years of such manipulations have created a self-aggravating crisis which is destroying the very industrial base of Germany.

The prospect of more such soaring labor "benefit" costs for workplaces is triggering a flood of foreign investment by German companies in such cheaper-labor places as Poland, Hungary, and China. The present 4.7 million unemployed is a direct result of such dangerous government budget manipulations. The government's practice of "financing" the *versicherungsfremde Leistungen* by a Social Security Tax on those paying into the system, instead of by a general tax on the total population which benefits from the program, creates, in effect, a one-sided penalty against jobs and job creation.

Because it is not a direct tax, however, politicians can tell voters they won't raise taxes, and will even cut taxes, as the present government has done. That is worse than a fraud, because these fiscal manipulations have jeopardized the very fundament of the entire German state pension system, the implicit social contract which has bound citizens and the state since the modern postwar Social Security system was reformed by Adenauer in 1957.

A German citizen who works hard his entire life to have a secure retirement, no longer has any guarantee, any "contract of generations," that he will have any pension in 20 or 30 years, after paying in for all those years at a sum of 22% or more. Why?

A temptation too great

Versicherungsfremde Leistungen are defined as obligations of the German Social Security system, which have nothing to do with the original "Generation Contract." The original contract simply calls for those working today, to directly pay the pension of those eligible recipients today. The state has the role to guarantee the smooth functioning of this, and to oversee the system, no more. This is called a "pay-as-you-go" system.

But, step by step, the government has raised Social Security Tax contribution levels beyond that needed to pay current pension levels, and dipped into the growing Social Security fund surplus to pay completely unrelated expenses. Today, the federal government takes an estimated 35% of total Social Security Tax income for *versicherungensfremde Leistungen,* purposes other than direct Social Security payments. But, it compensates that only by some 20% of the 35%, leaving a deficit in the *versicherungsfremde Leistungen* of some 15% yearly, which has to be covered, eventually, by higher taxation of employees and employers for Social Security, the tax on gross or pre-tax wages. This deficit, or uncovered sum amounted to some DM 57 billion alone in 1996, and is growing rapidly.

The various categories of *versicherungsfremde Leistungen* which are paid each year out of the Social Security system include:

- Obligations as a result of war: This includes DM 22 billion yearly for refugees who had to flee the east after the war, as well as those who came over during the existence of

the East German regime and now get western-level pensions, although they had paid in to the East German system.

• Schooling or training time after age 16 (trade school, etc.): DM 14 billion.

• Early retirement compensation (that is, an early pensioner who has not paid in for enough years, but still gets a pension). Each person going off employment into early retirement adds a double burden to the Social Security system, because he is no longer paying in, but rather taking out: DM 13 billion.

• Compensation for the time of on-the-job training: DM 7 billion.

• Labor-market-forced pension: Those who are unemployable before pension age.

• East Germany Social Security Equalization: compensation for those getting pensions in East Germany who require a supplement to meet western German levels after unification.

• Since Jan. 18, 1996, the federal government and parliament approved payment of pensions for 35,000 German-speaking Jews now living in Israel and the United States who suffered under the Nazis. Eighty percent of the cost will be paid out of the Social Security Fund.

This is only a partial list. The essential point is that these costs, while in and of themselves generally things which the state should support, are not being paid for by the state. The costs instead are being dumped into the Social Security Fund—that is, on the shoulders of employees and employers, who have to pay the tax, 50-50 into the Social Security Fund.

This represents a systematic plundering of the Social Security Fund by the Finance Ministry and the government, for purposes which they would otherwise have to put on the budget directly and seek appropriation for through taxation of the overall population instead of only those directly working and paying the Social Security Tax.

There is no independent oversight body responsible to represent the fiduciary integrity of the DM 331 billion annually paid to the Social Security Fund, and its administration. The Finance Ministry, which has been looting the fund in the first place, alone has the oversight, a bit like the proverbial fox guarding the hen house.

The *versicherungsfremde Leistungen,* not compensated by specific federal government contribution, is arguably a violation of the Federal Constitution as well. Article 14 of the Federal Constitution guarantees Social Security payment. The systematic plundering of the fund by the state for its *versicherungsfremde Leistungen,* and the refusal of Bonn's Finance Ministry to fully compensate that depletion with offsetting government payments, represents an unconstitutional expropriation of the legal wealth of the insured population as well as of the pension recipients. That expropriation can be measured each time the Social Security Tax level is increased.

Were the system, as most citizens believe it to be, and as it was intended, under the "Generation Contract," the 32.4 million working population contributing into the Social Security system today would finance the pensions of today's 19 million Social Security retirees, almost 4 million of whom are from the former East Germany. The only role of the state, would be to guarantee the proper functioning of this process, and to supervise its administration.

If the German Social Security system were run on that strict basis, unburdened from *versicherungensfremde Leistungen,* it is estimated that, today, the tax rate on employees' gross wages, as well as employer contributions, would stand at some 14% of pre-tax earnings or even lower, instead of the present 20.3%. Moreover, the system likely would be actuarially sound for years to come at that level, without endangering projected pension benefits, according to the estimates by Prognos AG.

Funds taken for other purposes

Especially since 1989, the Finance Ministry has systematically looted the contribution income for other, largely unrelated purposes, usually to avoid fighting for direct on-budget appropriation for those items. After unification, that looting of the Social Security Fund has increased enormously, partly to hide the huge unification costs taken on by Bonn off-budget.

It has been estimated that from 1980 to 1990, the total of such *versicherungsfremde Leistungen* which has been dumped onto employees and their employers, was a cumulative total of DM 389 billion ($230 billion), paid out of the employee and employer contributions to the Social Security Fund over those years. That is, if we take the total paid in to the fund, and deduct the so-called federal added contribution, we are left with a deficit of DM 389 billion for 1980-90 in the fund. That deficit has been financed simply by regular increases in the Social Security Tax rate paid by employees and employers.

Since unification, this deficit escalated dramatically. In 1993, the amount of *versicherungsfremde Leistungen* not covered by Government Contribution, left a deficit of DM 33 billion. In 1996, it had reached an estimated DM 57 billion. From 1990 to the end of 1996, an estimated DM 251 ($148 billion) additional deficit has arisen in the Social Security Fund, a deficit which has not in any way been covered by mandated federal government payments. This, added to the earlier DM 389 billion, means a total of DM 640 billion ($377 billion) cumulative deficit since 1980.

This cumulative deficit of DM 640 billion is the real "crisis" of the Social Security system, and the reason its reserves have disappeared. Only a few years ago, it was the practice that the Social Security Fund would have a minimum "reserve" on hand equal to two years' payout to pensioners. That gradually fell to one year's payout. Then it was reduced by Bonn to two months, then one month, and today it is zero.

Because the burden of financing the *versicherungsfremde Leistungen* does not fall on the general 80 million population but on a far smaller base of the 32 million employed, the costs for new employees put pressure on firms to drastically "down-

size" and go outside Germany to add new production capacity, destroying the competitive base of the German economy.

The role of Germany's anglophile finance

The major German banks have lost no time in attempting to profit from this scandal. The "Big Five" banks (Deutsche Bank, Dresdner, Commerzbank, Hypo Bank, and Bayerische Vereinsbank) in conjunction with Allianz and its joint partner, Münchener Re, form a cartel of financial interests, the heart of what, since the assassination of Deutsche Bank chairman Alfred Herrhausen in late 1989, has become the "British faction" in German policy today, an Anglo-Saxon-style "free-market" finance power.

Into the crisis created by the systematic looting and overloading of the Social Security system, prompted by the Maastricht Treaty for European Monetary Union, and uncompensated *versicherungsfremde Leistungen,* this private financial cartel, the Big Five banks and the insurance giants, are moving to de facto "privatize" the Social Security system to their benefit.

This financial group, which is also the locomotive behind Maastricht and the drive for a European single currency, is using the anxiety and fears of the population, to stampede them into buying their supplemental pension insurance privately. Each of the banks has special private Social Security Funds.

Playing on the growing fear that the state system will go bankrupt, the banks have created investment fund companies to convince families that private savings for retirement, via these banks, is the only way to secure their pension in 20 or 30 years.

Deutsche Bank recently issued an article by its chief economist, Norbert Walter, which was mailed to the hundreds of thousands of bank clients and depositors. It was an analysis of the state Social Security system over the coming 40 years, illustrated with a graphic designed to instill panic. The actual numbers of pensioners and contributors given, however, were not at all accurate.

Walter blamed all on demographics, ignoring the real issue. He declared that Germany's "demographic fair weather period is coming to an end. In the coming 10 years we have a brief pause for breath." But then the demographic shock will come, when the baby-boomer generation retires, and there will not be enough young working to support their pension in 20-25 years. He predicted a tax level for Social Security-insured working people by 2030 at 30% of gross wages, as well as a huge increase in the state Health Care Insurance Tax. "The state will be forced, at the latest in 15-20 years," Walter said, "to dramatically sink the pension level as well as dramatically raise the eligible age to get a pension, well above 65." That process has already begun.

Walter continued, "More and more citizens will attempt to get out from under the forced payment into the Social Security and Health Insurance systems. They will turn to off-the-books work, new forms of employment relations or self-employment. . . . The state can manage only a portion—the responsibility for one's financial future in the coming years will go more and more from the responsibility of the state onto that of the individual citizen. Self-initiative is demanded."

To emphasize its message, Deutsche Bank mailed out a flyer titled, "With Only Social Security You Won't Get So Far." It stated, "As an average earner today, you can count on, at best, having a pension of at most 45% of your last gross wage." The bank offers its services for a private Deutsche Bank investment plan.

Several years ago, Deutsche Bank created a new insurance affiliate, Lebensversicherungs-AG, which offers such investment retirement plans. As well, Deutsche Bank has DWS, Germany's largest investment fund group. DWS president Christian Strenger recently stated to the London *Financial Times:* "Governments in Germany and the rest of Europe can hardly provide full pension coverage in the future for their citizens. We are keen to develop our fund business for retirement purposes."

Dresdner has a similar fund affiliate, Deutscher Investment-Trust (DIT), as does Commerzbank, Hypo, and Bayerischer Vereinsbank. Through their central lobby group, BVI, these bank-owned investment funds are pushing in Bonn for schemes to encourage more people to place their savings in these funds. As the *Financial Times* put it: "DWS and its competitors are not acting out of altruism. They see big opportunities from pension fund business if the right incentives are created. In the U.S. for example, retirement funds play a large part in mutual fund business."

The EU Commission in Brussels is also working hard on a new EU-wide rule, titled "Freedom of Management and Investment of Funds Held by Institutions for Retirement," the so-called "Internal Market for Pension Funds." Today such private pension funds, mostly in the U.K., hold assets worth more than DM 2 trillion. The goal is to change national laws and restrictions, especially in Germany, to allow private pension fund investment to become part of the casino economy on a Europe-wide scale, with virtually no controls or restrictions. Through such massive manipulations, governments are, in effect, trying to prop up the global speculation bubble a few months longer, at the cost of destroying the confidence of their own population.

The fact that nearly every major industrial government in the world is, in one form or another, debating such draconian measures to dismantle or privatize their basic public pension systems, only underscores a larger point. There is no adequate quick-fix or band-aid patch-up of this present global monetary and financial system. Wrong fundamental economic policies over the past quarter-century, since at least the collapse of the Bretton Woods system in August 1971, have expanded the cancer of financial speculation at the expense of the real physical economy and living standards of the broader population. The "pensions crisis" is merely another term for the thorough bankruptcy of the present system.