

## **DEMOGRAPHIC AGEING AND POPULATION DECLINE IN TWENTY-FIRST-CENTURY GERMANY: CON- SEQUENCES FOR THE SYSTEMS OF SOCIAL INSURANCE**

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### INTRODUCTION

There is a fundamental link in most societies between economic production (that is to say, output) and demographic reproduction. A population's total fertility rate (TFR), expressed as the number of live births per woman, tends to be lower, the higher a country's level of development. I shall discuss the main causes of this "demo-economic paradox" in section B, and show its adverse consequences for the system of social insurance in Germany. Section C will summarize the main findings of our demographic projections computed for Germany in the twenty-first century, and section D will analyse the impact of these projected demographic developments on the social insurance system and set out the consequent policy options. Section E will sum up the conclusions to be drawn on the impact of economic globalization on population change and on the ability of social insurance systems to function properly in the future.

### THE DEMO-ECONOMIC PARADOX AND ITS SIGNIFICANCE FOR GERMANY'S SOCIAL INSURANCE SYSTEM

In theoretical biology, evolution is explained in terms of competition between different biological species, and between individuals of the same species, to attain optimum conditions for their life and reproduction. In human populations, too, competition among individuals and groups is an important principle determining action, so the principle's prominence in theoretical demography is similar to that in theoretical biology. Competitive behaviour has both positive and negative impacts on how we live together in human societies. Modern societies endeavour to make the best of the positive impact exerted by the competition for political power and economic success, by developing appropriate rules for democracy and the market economy. In social market economies like Germany, the negative impacts are restrained by means of comprehensive social welfare legislation.

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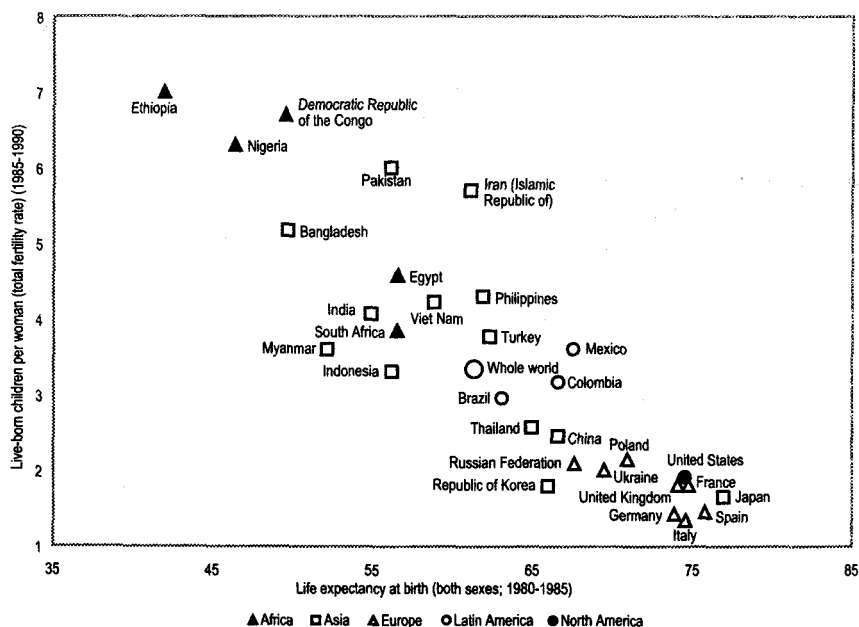
The more successful modern societies are in utilizing the beneficial effects of competition while avoiding its adverse effects, the less people need to rely on their own families, which always performed these tasks before the emergence of modern societies, and the larger is the fall in the value of having children "as an investment". So there is indeed an underlying logic to the inverse relationship that emerges between a country's level of development and its TFR. Yet it still appears a paradoxical outcome that people should be less willing to have children the more they can afford them. In Germany, for example, the number of live births per woman was twice as high in the 1960s as it is today (a TFR of 2.4 versus one of 1.3) even though real incomes have quadrupled since that time.

For decades, the positive net cost/benefit outcome of the German-style model of the social market economy appeared beyond dispute. However, in the last quarter of the twentieth century, it became increasingly clear that the economic success generated by this type of society was counterbalanced by a demographic failure that may yet prove destructive for both economy and society in future. The cause of this adverse trend lies in the demo-economic paradox which affects most countries of the world. Whether the comparison is made longitudinally, that is to say, by viewing the same country at different points in time, or as a cross section of countries at the same point in time, the same inverse correlation is found between live births per woman and the level of development, as expressed by indicators such as life expectancy, the United Nations Development Programme (UNDP) human development index, and per capita income.

This cross-section comparison is shown in figure I, which covers the world's 30 most populous countries, together accounting for 80 per cent of the world population. If the correlation is carried out for other points in time, the same falling curve appears. Evidently, this pattern of correlation is valid across the globe: it holds for most countries in the world, regardless of what kind of economic system or form of society they have and regardless of their histories, religions and cultures. So this has to be a fundamental mechanism, the stringency and force of which derive from the unbridgeable antagonism between the two basic human principles of action, namely, competition and the exclusion of rivals on the one hand and solidarity with and the *inclusion* of fellow human beings on the other.

Economic globalization is pushing outward the boundaries of national labour and goods markets. Although individuals still primarily compete as employees with others in their own national labour market, this direct competitive relationship is now supplemented by a less obvious and more indirect one which results from global competition in the markets for goods and services. National goods have to compete on the world market with similar goods and services from elsewhere, and these are likely to be all the more competitive, the lower the labour costs related to social insurance contributions to cover retirement pensions, health care and unemployment. These are the so-called non-wage labour costs that, in Germany, include the additional component of long-term care insurance. As far as the real, demographically generated cost burden is concerned, it is immaterial whether these costs are charged as a percentage

Figure I. Correlation between life expectancy in 1980-1985 and the number of children per woman (total fertility rate), 1985-1990, for the 30 most populous countries, covering 80 per cent of the total world population



Source: Author's own calculations based on United Nations (1999).

of wages and salaries or as a percentage of corporate profits: the increase in costs and the adverse impact on competitiveness are the same either way, and the difference is purely one of economic accounting.

Non-wage costs are a fundamental determinant of prices. The older the society, the greater the per capita expenditure on social insurance systems; hence, the greater the non-wage costs and, thus, the lower the country's global competitiveness. However, developed countries with high per capita incomes and high demographically determined non-wage labour costs will not automatically be swept out of the world markets by countries where both incomes and non-wage labour costs are lower. High incomes are based on higher productivity which can make up for, or perhaps even surpass, their less favourable labour-cost situation. Thus, high-wage countries will not necessarily be driven out of their markets by less developed countries. In fact, every country has scope to improve its position with regard to productivity and per capita income.

This competition among economies to obtain a favourable position encourages employees to invest in their skills and qualifications, so the average real wage level rises continually. On the other hand, the opportunity cost to a parent of turning down work for the sake of bringing up a child also increases just as fast as this real wage level. In developed countries, the resulting low

birth rate has created an "inverse" age structure: instead of the classic pyramid shape in which the youngest age groups make up the largest cohorts, these are now the middle-aged; and in Germany's case, those aged 70-74 are destined to become the largest five-year group in the future.

In Germany, the modern welfare State was introduced as far back as the late nineteenth century with the Bismarckian social reforms, which were continually improved upon during the twentieth century. The system now has a number of different features, including retirement pension, health, accident, and unemployment insurance, as well as provision for surviving dependants and, most recently, long-term care insurance. When it was first introduced in the 1880s, the social insurance system was tailored to an age structure based on the classic "population pyramid" form with a broad base of young people. The system operates on what is known as the "pay-as-you-go" principle, under which those currently in work pay their contributions into the various statutory insurance branches to fund the benefits paid out to the pensioners, unemployed etc. at that same time. Benefit payments and contributions take place simultaneously, in contrast to fully funded pensions in which capital is built up over many years to finance future benefits for the same generation.

For almost a century, this statutory benefits insurance system worked so well in Germany that hardly anyone needed to have children to ensure that they would be looked after in their old age or if they were in poor health. The very fact that the innovations carried out in social policy were so effective for many decades was itself one of the reasons why the system ultimately stopped working as the age structure changed owing to the low birth rate. Of course, the modern social insurance system is not the only reason why the birth rate has declined, but it is certainly one of the factors that influenced the demographic paradox, with all its consequences for a declining birth rate.

#### POPULATION PROJECTIONS FOR GERMANY IN THE TWENTY-FIRST CENTURY

To show how uncertain forecasts are, people often point out that weather forecasters repeatedly get it wrong. Yet weather forecasting offers a useful means to illustrate the use of demographic projections, which differ in nature from economic forecasts and various other predictions of future trends: seasonal changes, and associated aspects such as changes in average temperatures, can be predicted months in advance with greater reliability than, say, temperatures in the coming week. Though it may be generally true that predictions grow more uncertain the further into the future they look, the fields of climatology and demography offer some major exceptions to this rule. One of the most important of such exceptions is the phenomenon of demographic inertia, that is to say, the inbuilt momentum of population growth and decline: once the absolute number of births in a population has fallen owing to a change in reproductive patterns rather than to any change in the number of women of childbearing age, this will lead to a further reduction in future births, even if reproductive patterns remain constant following their initial change. Thus the initial change

is triggered by a change in reproductive behaviour, but subsequent downward movements in the absolute number of births, in a series of waves each a generation apart, are due not to any further behavioural change but rather to the simple fact that people who have not been born cannot have any offspring of their own. This impact on future births created by the reduction in the number of potential parents can be forecast with a similar degree of certainty to that of the seasonal changes in years to come, in other words, almost 100 per cent. Thus, it ought not to surprise us that demographic forecasts are substantially more reliable than, say, economic ones. For example, the forecast changes in the population of former West Germany up to the pre-unification period (1985) based on the 1970 census produced an error of 1.2 per cent.

The number of live births per woman (TFR) in Western Europe initially rose slightly after the Second World War, but fell back sharply thereafter. The TFR had increased from 2.39 in 1950-1955 to 2.66 in 1960-1965, but had fallen to just 1.48 by 1995-2000. In Germany (East and West combined), the rate went up from 2.16 in 1950-1955 to 2.49 in 1960-1965, before falling back to 1.30 in 1995-2000. In the whole of Europe, whose population in 2000 was 729 million, the corresponding figures are 2.57 (1950-1955), 2.56 (1960-1965) and 1.42 (1995-2000) (United Nations, 1999).

The general downward trend in the TFR in Europe after the period 1960-1965 was due to a change in reproductive behaviour which in turn had a broad range of causes, including a shift away from traditional "family values", greater sexual permissiveness, women's liberation, the growing number of working women (meaning that those who chose to raise children would miss out on greater earning opportunities, known as the "opportunity cost of children") and the increasingly effective cover against key life risks provided by the modern welfare State (making children dispensable as a form of family-based social insurance), and extending all the way through to such factors as the advent of modern contraceptives. Strictly speaking, these factors do not properly explain the change in reproductive behaviour because they are mutually dependent and because they themselves require explanation. However, no matter how the explanatory factors are fitted together to compose a cogent theory of reproductive behaviour, the impact of the changes that really have occurred on the number of potential parents growing up and the number of children they will have in the coming decades can be computed relatively precisely. The collection of essays by Voland (1992) offers an interdisciplinary review of modern theories of reproduction. This also includes the present author's biographical fertility theory, which endeavours to achieve a synthesis of the approaches of a number of disciplines (Birg, 1995, chap. 3, p. 45).

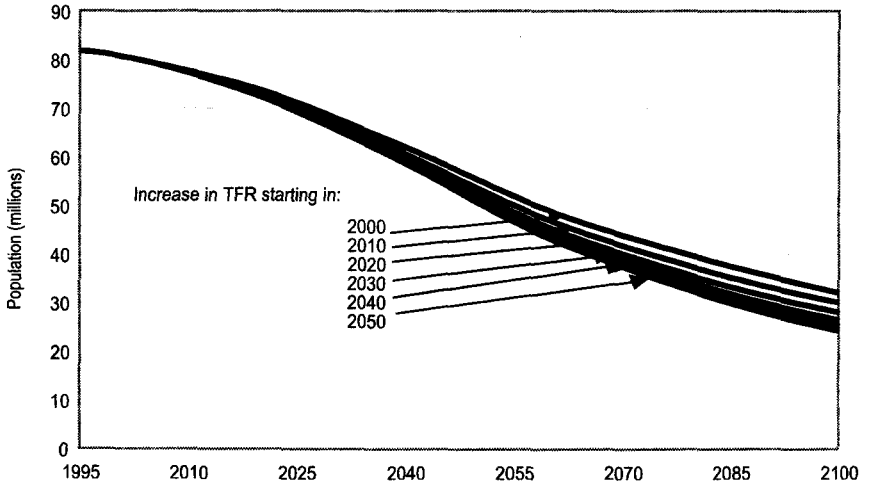
If no migration occurred in either direction, Europe's population would fall substantially by the year 2050, even if one were to assume, as the United Nations does, that the number of live births per woman will recover somewhat, from 1.42 in 1995-2000 to 1.78 in 2040-2050. On this assumption, the population would fall from 729 million in 2000 to 628 million in 2050 (United Nations, 2001, table 26). The United Nations projections also assume that the TFR in Germany will pick up from 1.30 in 1995-2000 to 1.64 in 2040-2050; yet even assuming the birth rate does grow to this extent, the population net of

any migration would then fall from 81.7 million (1995) to 58.8 million (2050) (*ibid.*, table A.4).

The reasons given above for past changes in reproductive behaviour will not lose their validity in future, so there is nothing to suggest that these factors will cease to operate and allow the TFR to increase again, as the United Nations assumes in its projections. Thus, it is interesting to analyse how the population will develop if different assumptions are applied. The main findings of the author's projections based on these differing assumptions (Birg, 1998) will be presented below as well as in figures II and III. Two variants have been computed, one with and one without migration, and each is divided into six sub-variants. The sub-variants are intended to show projected population sizes on a purely hypothetical assumption, like that of the United Nations, that the number of children per woman will again increase. However, the approach differs from that of the United Nations in that a choice of start dates for this increase is given, from the year 2000, the year 2010, the year 2020 etc., with the last alternative assuming that the increase does not begin until 2050, the end of the projection period. In each case, the number of children per woman (TFR) is assumed to increase from 1.25 (1995) to 1.50 over a 15-year period. The last of the sub-variants, in which the TFR remains constant until 2050, tells us how the population would develop up to 2050 if we rejected the assumption of the United Nations that the birth rate will rise: net of all migration, the population of Germany would shrink to 50.7 million by 2050 and to 24.3 million by 2100. Even if we assume annual net immigration of 250,000 young people, the population would still be set to fall to 66.1 million in 2050 and to 50.0 million by 2100. The assumed net migration figure of 250,000 immigrants is in fact quite high relative to the average of 170,000 in recent decades. If net inward migration was lower, the shrinkage in the population would be correspondingly more acute.

The severity of the decline in population despite assumed net immigration of 250,000 people per annum demonstrates the momentum involved in the process, due to the compound impact in each generation of the potential parents who were never born. This momentum of population decline substantially multiplies the birth deficit (that is to say, the excess of deaths over births in a given year) from about 100,000 at present to a peak of some 700,000 in the mid-twenty-first century. Even if net immigration is, say, 225,000 and the TFR holds its level of the last quarter-century at about 1.4 live births per woman, the increase in the birth deficit to approximately 700,000 is still inevitable (figure IV). So if one sought to counteract the birth deficit by net immigration, as has happened so far, this would call for an ever-increasing number of immigrants each year, rising to between 700,000 and 800,000—depending on the assumed TFR—by the year 2050 (figure V). This figure is substantially higher than the uniquely high rate of net immigration into Germany following the collapse of the Soviet bloc.

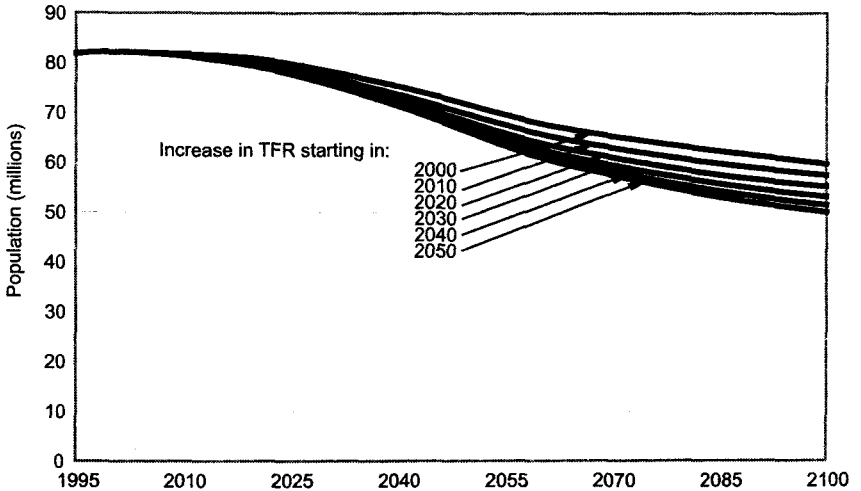
**Figure II. Population of Germany in the twenty-first century excluding migration effects, assuming an increase in the number of births per woman (TFR) from 1.25 to 1.50 over 15 years, starting from alternative points in time**



Source: Author's own calculations based on United Nations (1999).

NOTE: Assumed life expectancy: increasing to 81 years (men) and 87 years (women) by 2080.

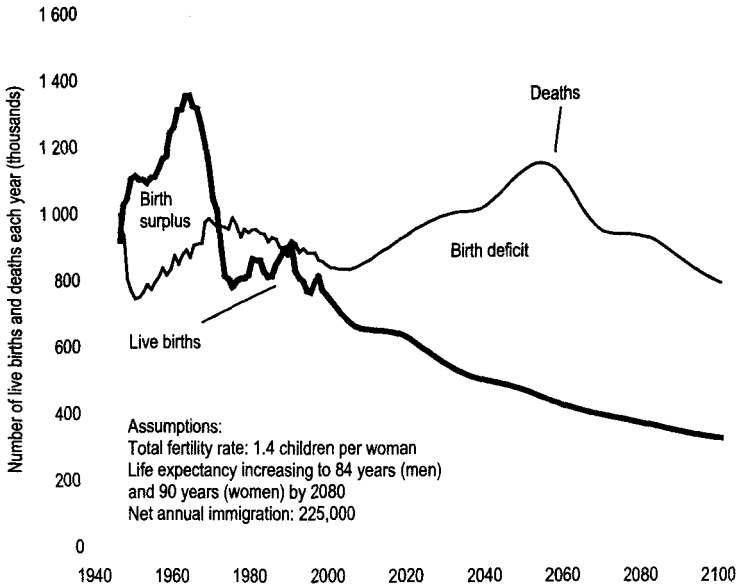
**Figure III. Population of Germany in the twenty-first century including migration effects, assuming annual net migration of 250,000 and an increase in the number of births per woman (TFR) from 1.25 to 1.50 over 15 years, starting from alternative points in time**



Source: Author's own calculations based on United Nations (1999).

NOTE: Assumed life expectancy: increasing to 81 years (men) and 87 years (women) by 2080.

**Figure IV. Absolute number of births and deaths and the gap between the two in Germany, 1946-1997 and 1998-2100**



Source: H. Birg and others, *Simulationsrechnungen der Bevölkerungsentwicklung in den alten und neuen Bundesländern im 21. Jahrhundert* (Bielefeld, Germany, University of Bielefeld, 1999).

NOTE: The curves plotted up to 1997 are based on actual figures.

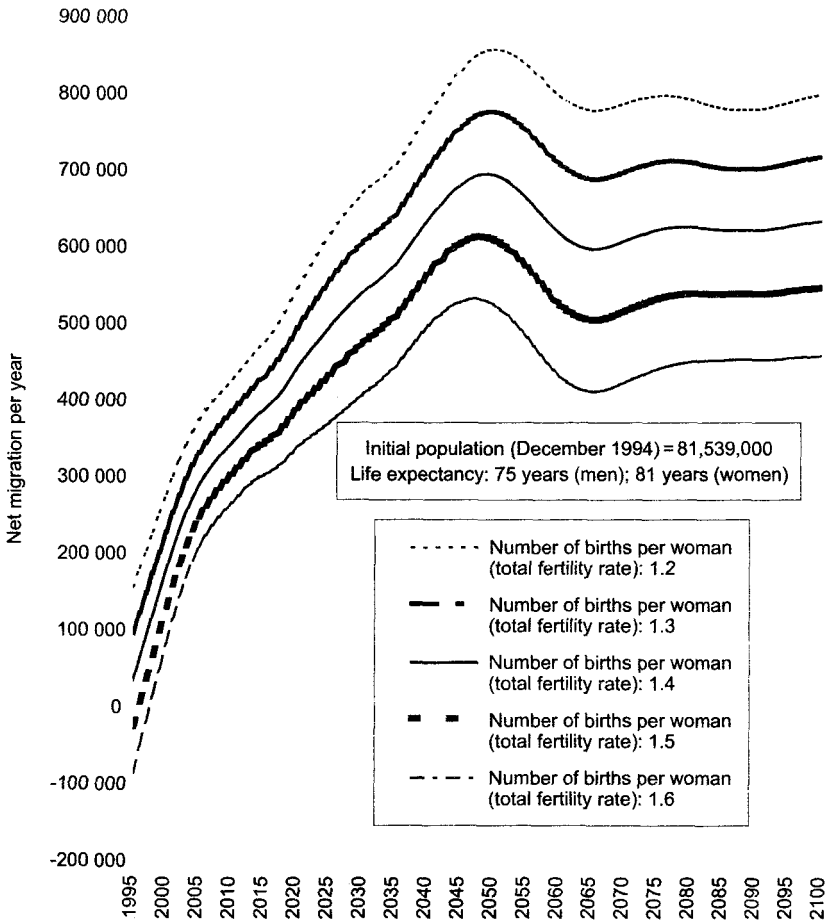
## THE CONSEQUENCES OF DEMOGRAPHIC TRENDS FOR GERMANY'S SOCIAL INSURANCE SYSTEMS AND THE POLICY OPTIONS AVAILABLE

### 1. *The extent of demographic ageing and the population decline in the twenty-first century*

The decline in absolute population size and the change in the age profile both have their own different impacts on our economy and society. As far as social insurance systems are concerned, the change in the make-up of the population in terms of age groups is a problem that is foreseeable and can be budgeted decades in advance. The impact of the fall in the absolute population size is rather more difficult to estimate, particularly as the number of older people in society will continue to rise while the number of younger ones is already in decline, leaving a relatively small net reduction in population size over the next 20 years. However, as time goes on, the shrinkage will gain ever more momentum. This will have a growing adverse impact on economic growth, thus creating an additional impact on the ability to finance welfare spending, for example, from tax revenues. Exactly how demographic changes will affect economic growth, and how severely, cannot be forecast precisely. By way of contrast, the effect an ageing society will have on the income and expenditure



**Figure V. Hypothetical net migration rate for a constant population number in Germany (for various birth rates)**

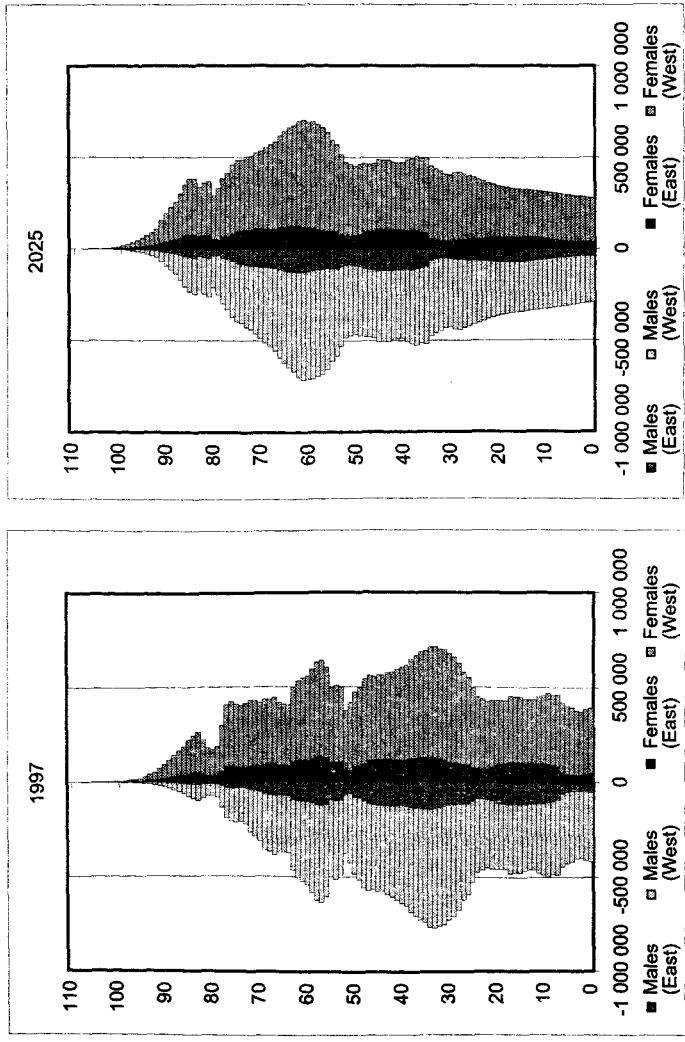


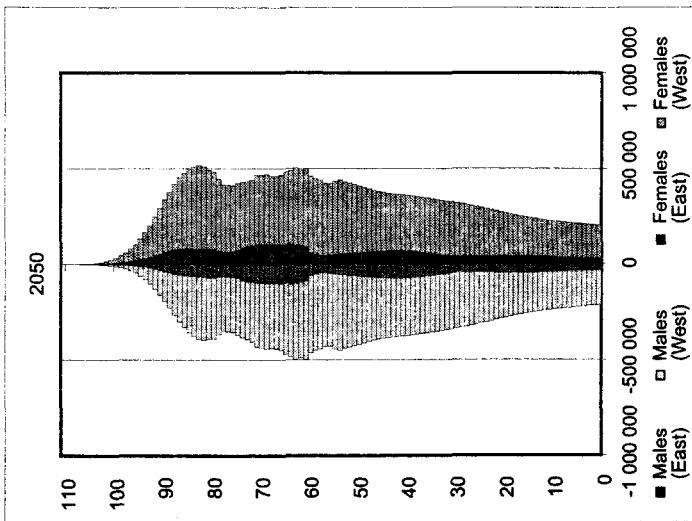
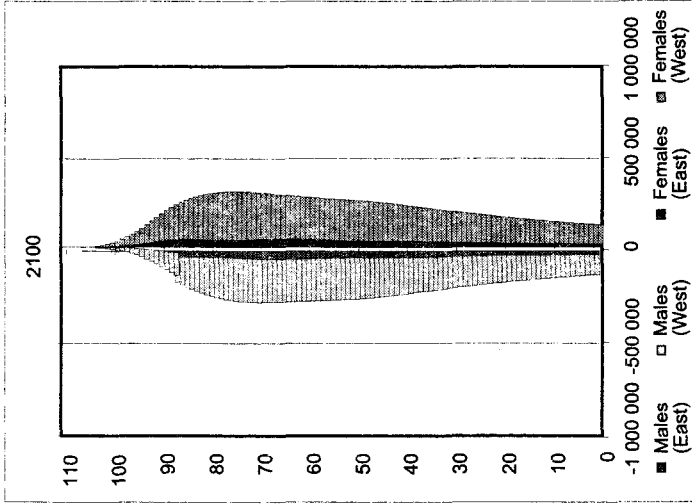
Source: H. Birg and others (1998).

of the social insurance system (retirement pensions, health and long-term care insurance) is clearly apparent even now. The comments that follow will concentrate on the latter issue.

The term “demographic ageing” refers to the increase in a society’s average age or, to be more precise, in its median age. The present median age in Germany is 38 years: one out of two males in the population is over age 37, while one out of two females is over age 40. Median age is set to grow not only because of the declining numbers in successive newly born age groups as the years move on but also because life expectancies are increasing. By the year 2050, one out of two males in Germany will be older than age 51, and one out of two females older than age 55. These estimates even include the assumption that there will be a net immigration of 150,000 younger people into Germany; if the immigration effect is ignored, the estimated median ages in 2050 will be 53 years for males and 58 for females (see figure VI, and Birg and others, 1998).

**Figure VI. Development of the age profile in former West Germany (Federal Republic of Germany) and East Germany (German Democratic Republic) (population projection variant No. 5: including migration and economic feedback)**





Source: H. Birtg and others, *Simulationsrechnungen der Bevölkerungsentwicklung in den alten und neuen Bundesländern im 21. Jahrhundert* (Bielefeld, Germany, University of Bielefeld, 1999).

To make the impact of demographic ageing on social insurance systems as clear as possible, we can measure it not just via median age but also via the "ageing index": this is normally expressed as the number of persons aged 60 or over for every 100 people aged 20-59. The inverse value of the ageing index is referred to as the "potential support ratio". Depending on what happens to the birth rate, life expectancy and net immigration, Germany's ageing index will increase to a value between two and three times today's figure by 2050. Even on the hypothetical assumption that life expectancy remains constant, the index will nevertheless at least double. The demographic projections commissioned by the German Insurance Association to address the pension reforms in 2000 offer the following key figures: the number of persons over age 60 will increase from 17.9 million in 1998 to 27.8 million in 2050, while the number of people in age group 20-59 will fall from 46.5 million to 30.4 million in the same period, which means that the ageing index is projected to rise from 38.6 to 91.4, by a factor of 2.4 (middle variant: see Birg and Börsch-Supan, 1999, p. 162).

## 2. *The changing age profile*

In the report for the German Insurance Association cited above, the author computed dozens of demographic variants incorporating different assumptions regarding the birth rate, net immigration levels and future changes in life expectancy. The account given below summarizes the changes in age profile computed for the middle variant (population projection variant No. 5), also shown in figure VI. The population projections and the assumptions applied are subdivided into four groups, namely, German citizens in former West Germany (Federal Republic of Germany) and in former East Germany (German Democratic Republic), and immigrants in former West Germany and in former East Germany. For Germany as a whole, the assumptions applied to these four subpopulations can be summarized as follows:

(a) The mean number of live-born children per woman, which changes over the course of time, is 1.25 for German citizens and 1.64 for immigrants;

(b) Life expectancy at birth rises steadily from 74.0 to 80.9 years for males and from 80.8 to 86.9 years for females. Life expectancy among the immigrants is assumed to be initially approximately five years higher than for German citizens, owing to the favourable selection effect of migration, but to gradually fall back to the same level as for Germans;

(c) Net immigration is assumed to average 170,000 per annum.

These assumptions also include the feedback effects of economic growth on the birth rate and net migration.

The number of young people (under age 20) decreases steadily from 17.7 million in 1998 to 9.7 million in 2050, while the number of people aged 80 years or over increases in the same period from 3.0 million to approximately 10.0 million. The number of persons under age 40 in 1998 was still substantially higher than that of persons aged 60 years or over (42.3 million versus 17.9 million). In future, this relative picture will be reversed, and there will be more people aged 60 years or over than under age 40 (tables 1 and 2).

The proportion of the population under age 20 is set to decline from 21.6 to only 14.3 per cent by 2050 while the proportion of persons aged 60 years or over will increase from 21.8 to 40.9 per cent by 2050. The increase in an age group's proportion of the total population is most pronounced for the oldest population group, aged 80 years or over, which in 1998 accounted for only 3.7 per cent of the population but in 2050 is projected to constitute 14.7 per cent of the total. From 2050 onwards, the proportion of persons aged 80 years or over remains similar to that of persons under age 20.

TABLE 1. POPULATION AT START OF THE YEAR  
(Millions)

Age (years)	1998	2030	2050	2080
Under 20 . . . . .	17.7	12.0	9.7	7.8
20-39 . . . . .	24.6	16.3	13.4	10.4
40-59 . . . . .	21.9	19.9	17.1	13.1
60 or over . . . . .	17.9	29.4	27.8	21.7
80 or over . . . . .	3.0	6.6	10.0	7.6
TOTAL POPULATION	82.1	77.5	68.0	53.1

TABLE 2. SHARE OF TOTAL POPULATION TAKEN UP BY VARIOUS AGE GROUPS  
(Percentage)

Age (years)	1998	2030	2050	2080
Under 20 . . . . .	21.6	15.5	14.3	14.6
20-39 . . . . .	30.0	21.0	19.7	19.6
40-59 . . . . .	26.7	25.7	25.2	24.7
60 or over . . . . .	21.8	37.9	40.9	40.9
80 or over . . . . .	3.7	8.5	14.7	14.3
TOTAL POPULATION	100.0	100.0	100.0	100.0

### 3. Consequences for the statutory pension system

#### (a) How the "pay-as-you-go" system works

For by far the most part, Germany's statutory pension insurance operates on the "pay-as-you-go" system. In other words, those contributing to the system today are effectively not saving up for their own retirement pensions, but directly financing the amounts being disbursed to today's pensioners. By the time current contributors have reached retirement age, the contributions that they have made during their working lives will already have been spent, so that their pensions will have to be funded by the younger generations still engaged in work.

If the ratio of people requiring pensions to those effectively paying the pensions increases over a period of time by a factor such as 2.4, the result is either that contribution rates to the statutory pension have to be raised by that same factor or that the level of pensions paid out (expressed as the average pension in relation to average earned income) has to be cut by 1/2.4. Thus, the core dilemma facing policy makers is to choose between either more than

doubling the contribution rate (currently 20 per cent) over that period of time, more than halving the pension level from the present 70 per cent, or funding even more of the statutory pensions system out of general taxation than is already the case.

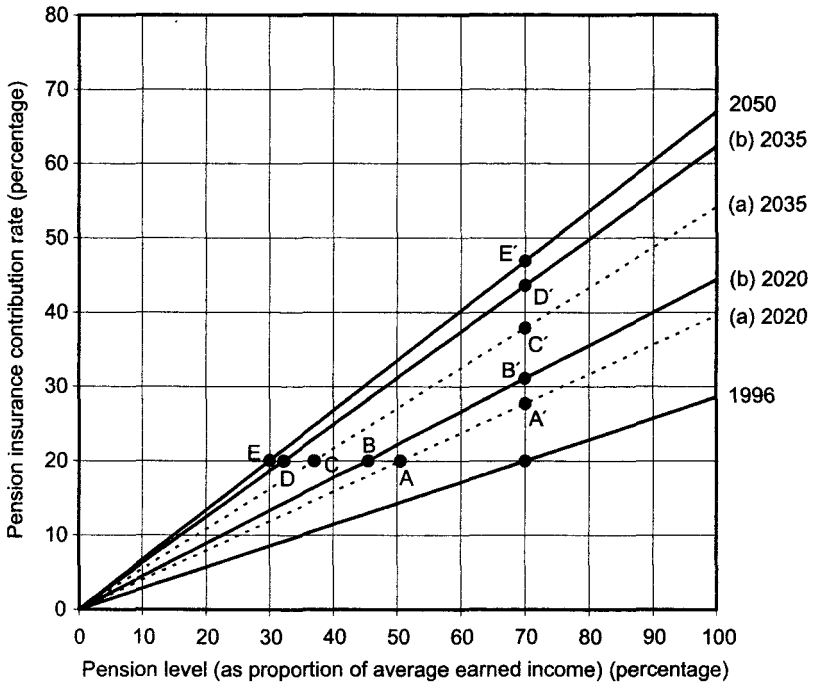
These alternative prospects, though politically untenable, are nevertheless objectively inevitable. This being so, measures have already been taken over the past 10 years, unnoticed by most of the general public, to chip away at the level of benefits paid out by the statutory pension system and hence reduce the size of the necessary increase in contributions. Among the little-known benefit changes now legislated are measures such as heavier deductions in pensions paid to early retirees, the crediting of only a maximum of three years for school education instead of the previous seven, a reduction in the value now attached to a contributor's early working years, cuts in the pensions paid for partial occupational disability, and overall reductions in the proportionate pension level over time in accordance with the "*demographic factor*", intended to automatically cut real pensions in line with increased demographic ageing.

(b) *Policy option I: increased contribution rate or lower pensions*

Figure VII illustrates the fundamental interrelationship, inherent in the pay-as-you-go principle, between the statutory pension contribution rate, the ageing index and the pension level as defined above. If policy makers wish to cut the contribution rate, they also have to cut the proportionate pension level, or vice versa. The options available are shown as points on a straight line, the gradient of which is determined by the ageing index. At present, demographic ageing has not yet shown through very strongly, so the lowest of the straight lines with the shallowest gradient applies. However, that gradient will increase over time in proportion to the ageing index itself. This increase will certainly occur, simply because of the declining number of people in age group 20-60. In other words, the gradient will increase even if there is no change whatever in life expectancy. Yet in practice, life expectancy at birth actually doubled during the twentieth century, and it is still increasing at an average rate of six to eight weeks each year. So even if the increase tails off in the future, a further growth in life expectancy by at least five to six years is quite likely. In the report we were commissioned to prepare in connection with the pension reforms, the middle variant envisaged an increase from 74.0 to 80.9 years for males and from 80.8 to 86.9 years for females. The increasing life expectancy (variant "b") makes the gradients in figure VII even steeper, raising the contribution rate required to maintain the same pension level even higher than under constant life expectancy.

Even under the unrealistic assumption that life expectancy will not rise any further, the Scientific Advisory Council to Germany's Federal Ministry of Economics has calculated that the contribution rate would need to rise from today's approximately 20 to about 40 per cent if the Government wished to maintain the present proportionate pension level of 70 per cent (Bundesministerium für Wirtschaft, 1998, p. 37). Figure VII shows a similar result. However, if life expectancy does go on rising, the rate needed to maintain pension levels will

**Figure VII. Relationship between the statutory pension contribution rate, the pension level and increased life expectancy**



Source: "Simulations, scenario 4", *Materialien des IBSs* (Bielefeld, Germany: University of Bielefeld), vol. 45 (1999).

NOTE: Assumed life expectancy increases since 1994-1996 and ageing index (AI) for chosen years:

- 1994-1996: males 73.3 years, females 79.7 years; AI = 37.5
- 2020 (a): no increase; AI = 51.0
- 2020 (b): plus 3.7 years; AI = 58.4
- 2035 (a): no increase; AI = 71.0
- 2035 (b): plus 5.3 years; AI = 81.8
- 2050: plus 6.7 years; AI = 87.9

need to increase much more, to some 46 per cent. An alternative would be to maintain today's contribution rate but cut the pension disbursed to about 30 per cent of average earned income. This makes explicit the covert contribution increase implied by using general taxation to help finance the statutory pension.

The general public is largely unaware that the last round of pension reforms was based on demographic projections produced by the Federal Statistical Office (in its eighth coordinated population projection) that worked on the unrealistic assumption of no further increase in life expectancy from 1 January 2000 onward. The expert report by the Scientific Advisory Council

is also based on these unrealistic figures. It was not until its next projection published in July 2000 (the ninth coordinated population projection) that the Federal Statistical Office also built in the assumption of further increases in life expectancy, which our figure VII has already catered for.

(c) *Policy option II: raising the retirement age*

If the options of cutting the level of pensions or raising contribution rates are not acceptable, a drastic increase in the retirement age will be unavoidable. By calculating age indices with a moving retirement age at one-year intervals (61, 62, 63, ... , 73), we can establish in which years the retirement age would need to be raised, and by how much, so as to maintain the ageing index constant by virtue of this boundary shift. The dates at which retirement age would need to be raised as ascertained in variant 5 of the projections made for the German Insurance Association are shown in table 3.

TABLE 3. INCREASE IN RETIREMENT AGE NEEDED TO MAINTAIN A CONSTANT AGEING INDEX BY SHIFTING THE AGE GROUP BOUNDARY

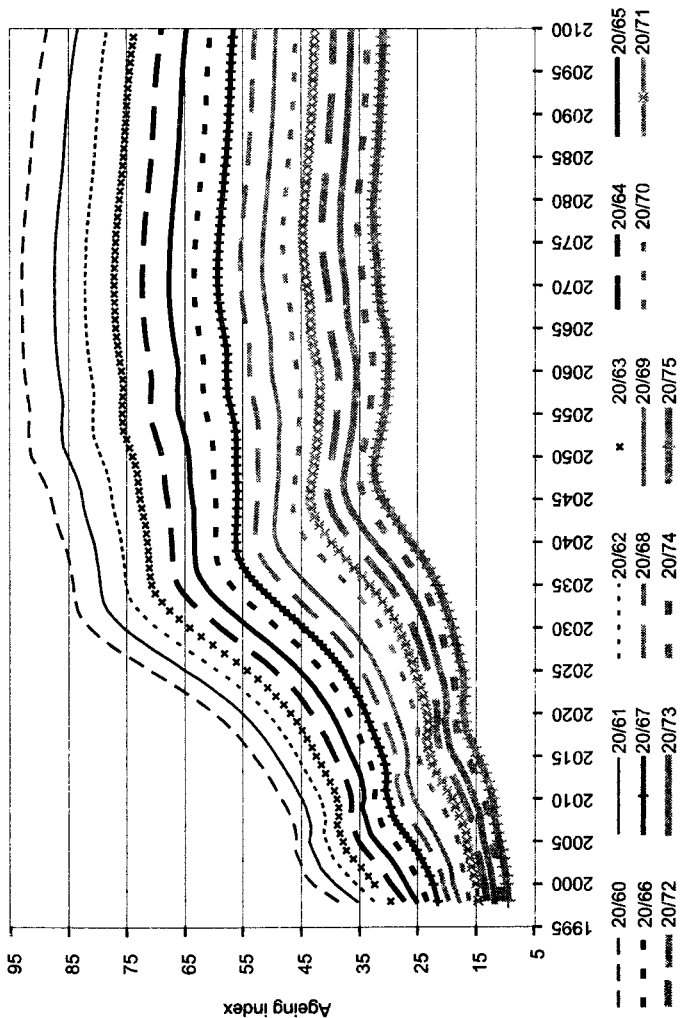
<i>Increase in the retirement age from ... to ...</i>	<i>This increase will be needed in the year ...</i>
60 ⇒ 61	2000
61 ⇒ 62	2002
62 ⇒ 63	2006
63 ⇒ 64	2014
64 ⇒ 65	2018
65 ⇒ 66	2022
66 ⇒ 67	2026
67 ⇒ 68	2029
68 ⇒ 69	2031
69 ⇒ 70	2036
70 ⇒ 71	2039
71 ⇒ 72	2042
72 ⇒ 73	2074

The retirement age, currently about 60 years in practical terms (though formally for men it is still 65 years), would have to be steadily raised to really be 65 years by 2018, 70 years by 2036 and, finally, 73 years by 2074: if this were not done, the ageing index with its crucial impact on increased contribution rates would inevitably increase (figure VIII). Even if the immigration rate of younger people is high, the ageing index will increase at least by 100 per cent for a constant life expectancy (figure IX) or by up to 200 per cent for a parallel increase of life expectancy (figure X).

An increase in the retirement age is not only unpopular but also unrealistic. For one thing, only a minority of the elderly population would be in good enough health to keep working right through to age 65, or indeed 73—male life expectancy is currently 74 years, and assumed to rise in future to 80 years; and for another, businesses mainly prefer to employ younger people. There are many occupations today, not just that of pilot or information technology (IT) expert, in which employees 40 or 50 years of age are already considered

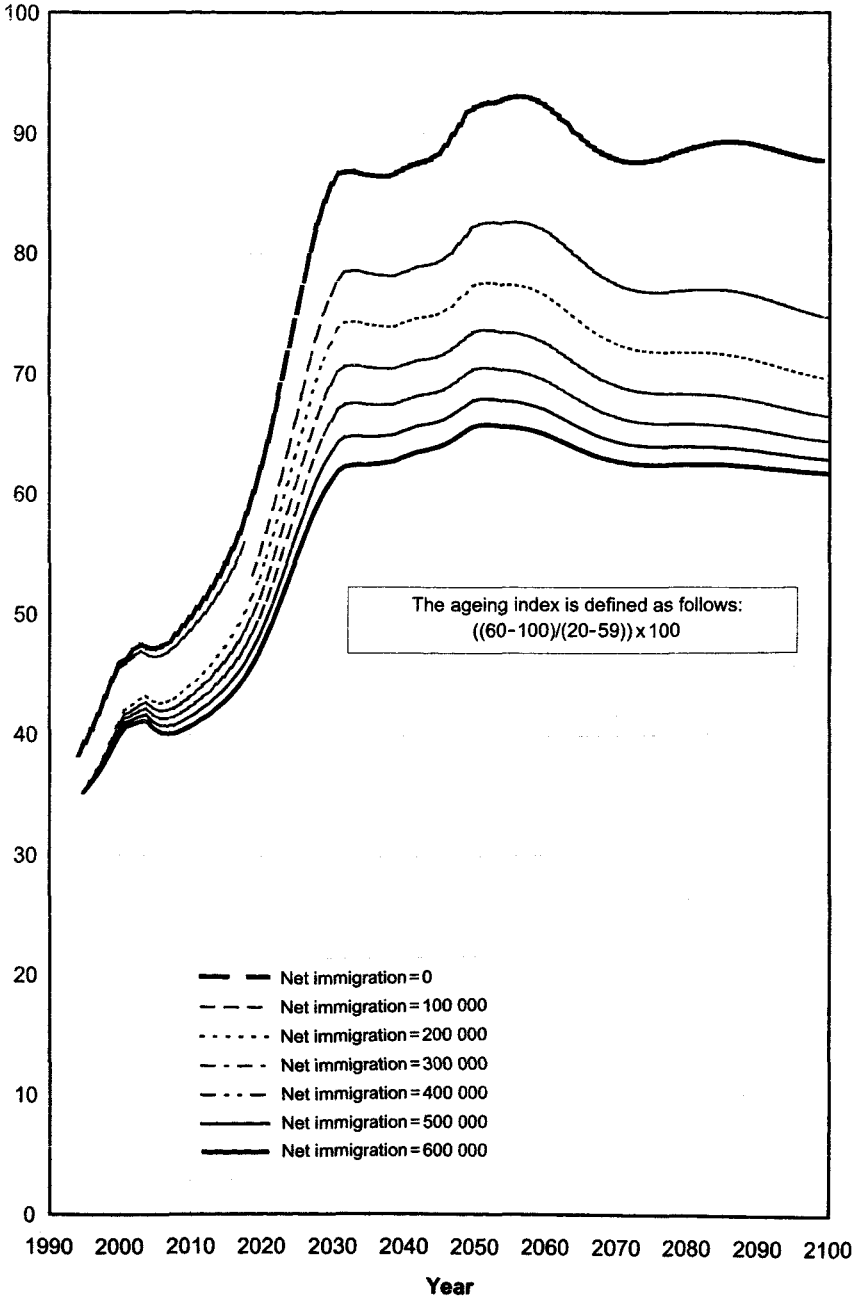


Figure VIII. Course of the ageing indices based on differing boundaries between the age groups



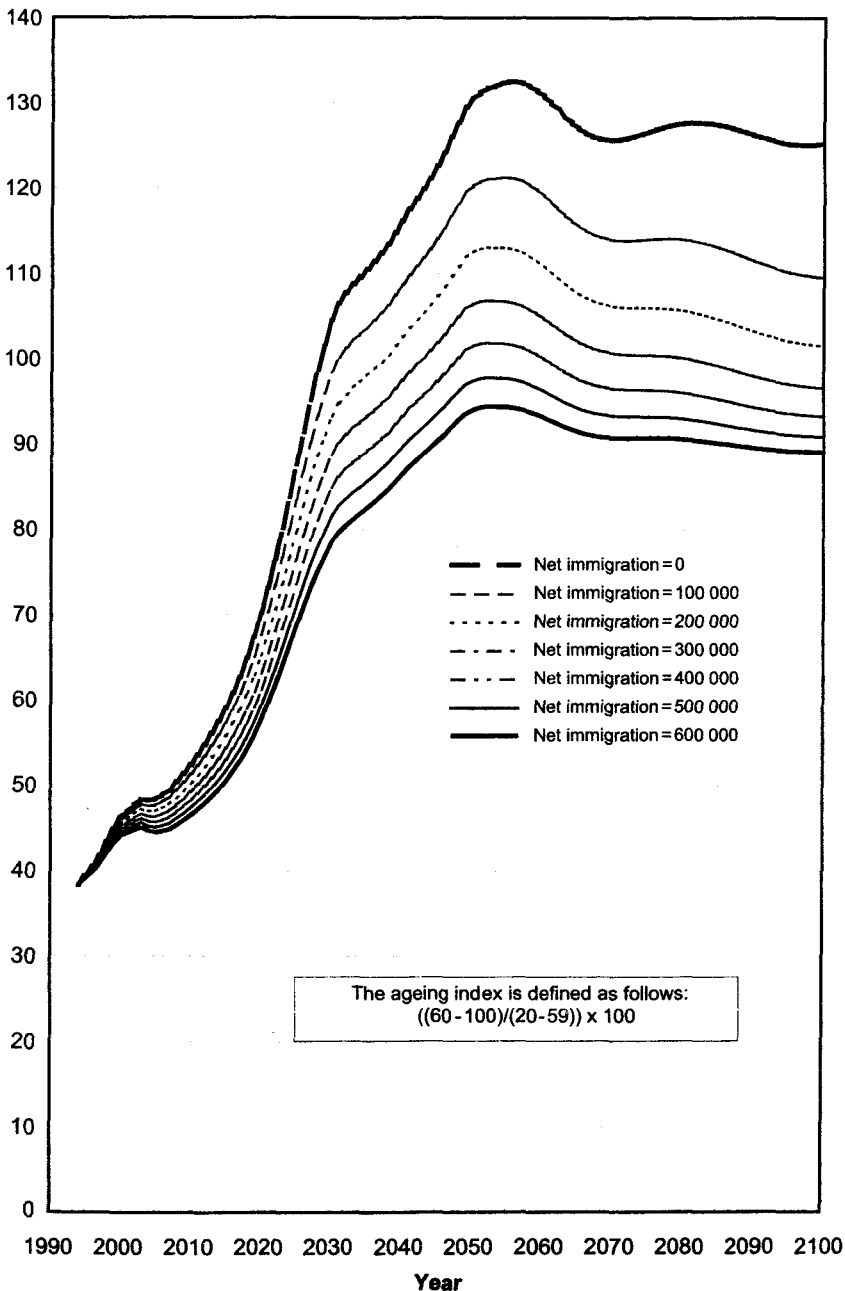
Source: H. Birg and E.-J. Flothmann, "Demographische Projektionsrechnungen zur Rentenreform 2000: Gutachten für den Gesamtverband der deutschen Versicherungswirtschaft" (projection variant 5), Berlin, 1999.

Figure IX. Course of the ageing index taking account of differing annual rates of net immigration (assumptions: TFR = 1.358; expectancy at birth (eo) = 75 years (males), 81 years (females))



Source: Own calculations.

Figure X. Course of the ageing index taking account of differing annual rates of net immigration (assumptions: TFR = 1.358; expectancy at birth (e<sub>0</sub>) = 84 years (males), 90 years (females))



Source: Own calculations.

rather old for the job. The more dynamically economies develop in the wake of globalization, the more rapidly the relevance of the knowledge acquired in occupational training will decline, and the less value will be placed on experience, a form of capital that grows with age.

*(d) Policy option III: immigration and an increased birth rate*

High levels of net immigration adding 600,000 or more per annum to the population cannot prevent an increase in the ageing index, even if life expectancy ceases to rise, let alone if it does keep growing as expected. If net immigration stayed at the level of recent decades (approximately 170,000 per annum) and life expectancy went on rising to 84 years (males) and 90 years (females), the ageing index would roughly treble from the current 38 to some 115 by 2050.

If an attempt were made to avoid the increase in the ageing index solely by allowing younger people to immigrate, the United Nations has calculated that a total of 188 million people (net) would need to immigrate into Germany by the year 2050 (United Nations, 2001, table A.4). The reason this figure is so high is that the immigrants would cut back the ageing index only temporarily, before making their own contribution to its increase once they reached retirement age, thus leaving only a small net easing effect, especially since the birth rate among immigrants to Germany is too low to have any lasting effect on the age profile of the population. Statistically, if both parents are foreign nationals, the number of live-born children per woman is 1.5. If the mother is a foreign national and the father a foreign or a German national, the rate is 1.9 (Statistische Bundesamt, 1999, p. 51). Either way, the TFR is below the 2.1 figure required to assure the long-term stability of the population. Nevertheless, because Germany's immigrant population currently has a younger age profile, it is set to increase from 7.4 million in 1998 to 10.0 million in 2050, even without any additional net immigration, before subsequently declining to 6.8 million by 2100 (Birg and Börsch-Supan, 1999, p. 150).

Another flight of fancy produces an equally sobering result: any attempt to halt the rise in the ageing index solely by increasing the birth rate would call for an increase in the number of live births per woman from about 1.3 to 3.8 (Birg and Koch, 1987, p. 174). This, of course, is a utopian notion given that even the developing countries with the highest TFRs in the world average only 3.0 live births per woman (United Nations, 1999).

As already shown in figure V, a higher birth rate would indeed somewhat reduce the net number of immigrants needed for the hypothetical purpose of keeping a constant population, but even with a TFR of 1.6 live children per woman the annual net immigration in mid-century would still have to be 300,000-500,000 people.

Thus, to summarize some of the conclusions so far:

- Because the falls that have already occurred in the number of births will inevitably give rise to further substantial falls in future years, it is impossible to prevent demographic ageing whether by changing policy to encourage larger families or by moderately increasing the

net number of relatively young people immigrating into Germany. The demographic ageing of society can only be alleviated a little by demographic measures; it cannot be brought to a halt;

- Germany's system of retirement pension insurance was designed in the late nineteenth century for a population that had a young age profile. The decline in the birth rate during the twentieth century will markedly increase the ratio of elderly people to those of working age in the twenty-first century. The only way of retaining the present pay-as-you-go system of statutory pension insurance without increasing contribution rates and/or lowering the pension level is to raise the retirement age to 70 years and beyond.

The ultimate conclusion is that the statutory pension system, currently based on the pay-as-you-go principle, has to be reformed and adapted to the changing age profile of the population. To avoid both excessive increases in contribution rates and all-too-drastic cuts in the pensions paid out, additional provision for old age on an individual basis via private savings is needed: this will be substantially less dependent on demographic factors than the current statutory system. However, the statutory pay-as-you-go pension insurance system cannot be totally replaced by fully funded individual retirement provision—it can only be supplemented by it. Total substitution would imply replacing the demographically derived security implicit in raising children by a form of provision totally dependent on the capital markets. By its very nature, this would provide less and less security, the more profitable the investments needed to be, since these would then involve greater risk and increasingly have to be placed in foreign markets.

#### 4. *Impact on statutory health insurance*

At least hypothetically, the lost revenues and increased expenditure for the statutory retirement pension scheme can be restrained by raising the retirement age. However, the health and long-term care insurance systems do not even have this purely theoretical avenue open to them: increasing per capita expenditure on health care as the population grew older would still be just as inevitable, even if raising the retirement age were not a problem.

People at a very advanced age need, on average, about eight times more spent on their health than do people age 20, as the North Rhine–Westphalian health ministry has found (Ministerium für Gesundheit und Soziales NRW, 1995, p. 174). This is partly because older people tend to need more medical attention in the normal course of their lives than younger ones, and partly also because the older the age group, the greater the number of deaths, hence the rise in health-care costs. In 1997, just one man aged 20–25 years died per 1,000 in this age group, whereas the figure was 111 per 1,000 in age group 80–85, and 256 per 1,000 in age group 90 or over. Moreover, technical progress in the medical field means that the “centre of gravity” in the age profile of per capita health-care spending is continually pushing upward. While the ratio of per capita health spending on young age groups to such spending on old age groups was 1:8 in 1992, these shifts could alter the ratio to 1:20 by the year

2040, according to the German Parliamentary Commission of Enquiry on Demographic Change, based on the findings of a study by the Prognos Institute (Enquete-Kommission, 1998, p. 230).

Demographic ageing increases the expenditure and lowers the revenues of the statutory health insurance system. Because of the reduced number of people of working age resulting from demographic factors, the system will have less contributors and hence suffer a loss of revenue, amounting to some 30 per cent by 2040. Simultaneously, expenditure is set to increase owing to two factors, namely, an increase in the pure number of older people coupled with the increase in the per capita expenditure on health care needed for older age groups. Our own simulations estimate that these two factors will generate additional expenditure needs at constant prices of some 22 per cent by 2040.

The widening gulf between rising expenditure and falling revenues will require contribution rates to the statutory health insurance organizations to rise from the present average of approximately 12 to about 21 per cent, unless either standards of care are reduced or participants are required to fund a substantially greater proportion of costs themselves. These findings operate on the assumption that future technological advances in medicine will not push up costs at all or, in other words, that there will be no upward shift in the age profile of per capita health-care expenditure. If the ratio of per capita expenditure was indeed to rise from 1:8 to, say, 1:20, as discussed above, the contribution rate would have to be further increased from 21 to 24 per cent. This relatively small additional margin of 3 percentage points for such a drastic shift in the age profile due to medical progress shows that the need for higher future contribution rates is driven much more by falling revenue than by increased expenditure, the momentum of which is reduced by the fact that the number of persons aged 60 years or over begins to fall back again after rising in the period up to 2030-2035 (figure XI).

##### *5. Impact on long-term care insurance*

As in the case of health insurance, the statutory long-term care insurance programme will also be affected by demographic ageing as it lowers revenues and increases expenditure. A similar pattern emerges insofar as the per capita expenditure on long-term care increases steeply with age. In 1996, for example, 4 out of 1,000 participants in the statutory scheme in age group 35-39 received benefits from it, compared with 24 per 1,000 in age group 65-69 and 280 per 1,000 in the age group 80 or over. Demographic simulations conducted by a number of institutes have calculated that the contribution rate for long-term care insurance would need to rise from the current 1.7 per cent to between 3 and 6 per cent by 2040 (Enquete-Kommission, 1998, p. 126). Yet even the upper projection of 6 per cent will probably be insufficient, as the following computations on the increase in the "demographic senior citizens' care index" shows.

The demographic senior citizens' care index used here consists of the number of people of advanced old age (where the need for care is most prevalent) per 100 people in the age group that is 20-40 years younger than they are, who normally take responsibility for caring for the elderly. The index has been

calculated using alternative borderlines, initially treating “advanced old age” as meaning 80 years or over, then 81 years or over, and so on up to 90 years or over. Correspondingly, the age groups assumed to be responsible for providing care are 40-59, 41-60, and so on. The first alternative is expressed in the formula

$$\text{Care index } P_{80/(40-60)} = \frac{\text{Population aged 80+}}{\text{Population aged 40-60}} \times 100$$

The calculations made on the basis of the middle projection variant for the German Insurance Association produced the following results (figures XII and XIII):

(a) Age group 80 years or over, in which the largest number of people requiring care are found, will treble in size between 1998 and 2050, from 3.0 million to 9.9 million, as the large cohorts born in the 1960s reach their old age;

(b) The number of men over age 80 is at present considerably smaller than the number of women over age 80, owing to wartime losses (0.8 million men versus 2.2 million women). In future, the number of men in this age group will return to normal, growing to 3.9 million in 2050, while the number of women increases to 6.0 million;

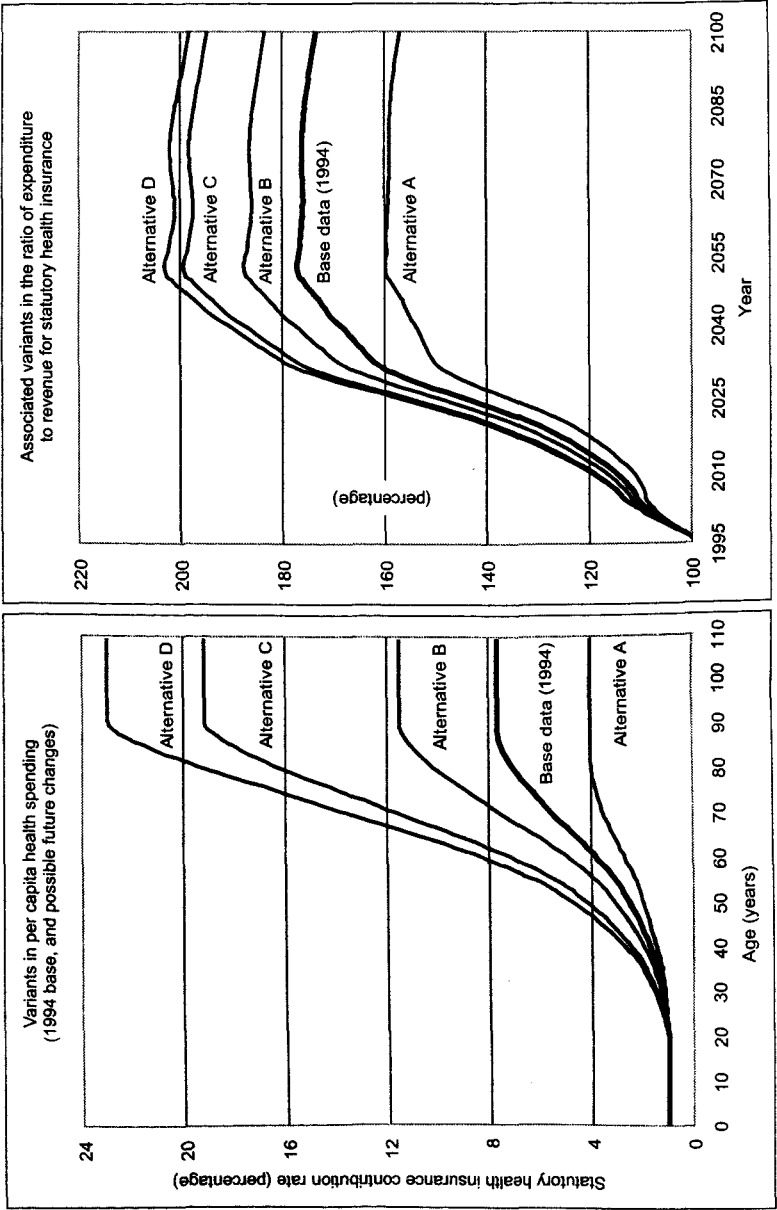
(c) The demographic senior citizens’ care index for persons aged 80 years or over (relative to 100 people in age group 40-60) is set to quadruple from 12.6 in 1998 to 55.0 in 2050. In other words, one person in every two aged 40-60 years will be “matched” by a person aged 80 years or over with the much higher likelihood of requiring care. The increase among men will be more marked than among women;

(d) The care index relating the number of people aged 90 years or over to 100 persons aged 50-70 years was 2.3 in 1998; this is projected to grow to 10.8 in 2050, and, by a factor of six, to 14.1 in 2059;

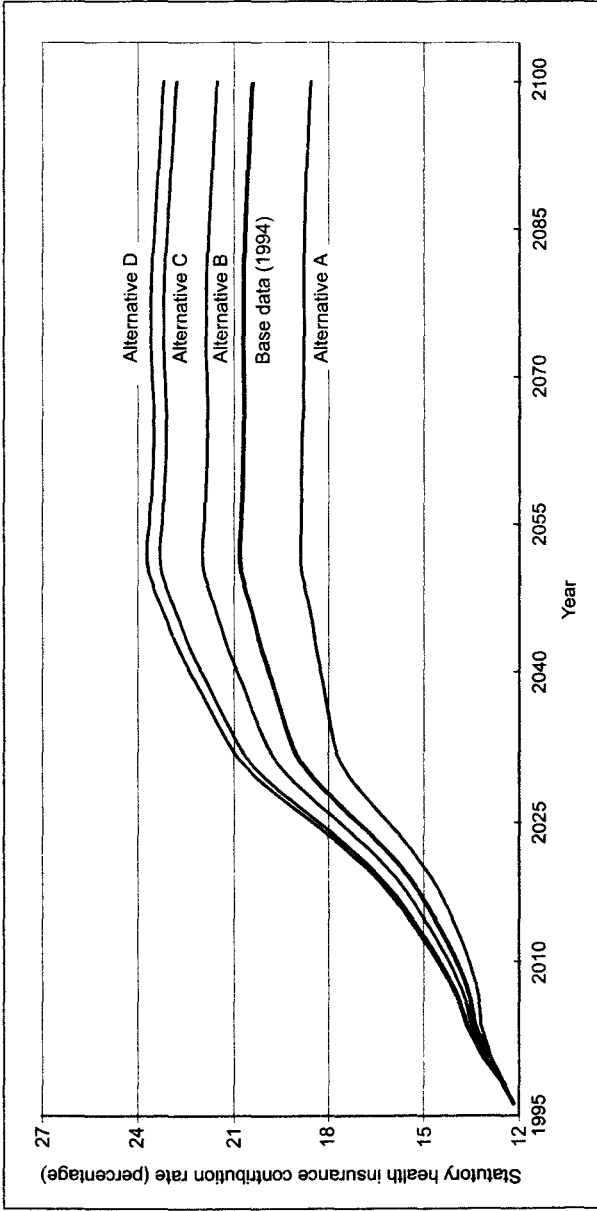
(e) The further life expectancy of people who have already reached age 70, 80 or 90 has increased much more significantly in recent decades than the further life expectancy of younger people, where marked advances already occurred some years ago. This trend will continue in the twenty-first century. The number of people in the German population aged 100 or over—a significant figure from the care point of view—was estimated at 11,000 in 1998, but is set to increase to 70,000 by 2050 and to peak at 115,000 in 2067 (figures XIV and XV).

The care index applied above measures only the direct, demographically determined increase in the cost burden for long-term care associated with the shift in the population’s age profile. However, another demographically induced set of costs involving a slightly less direct route flows from the dramatic increase in the number of people who remain childless throughout their lives. In younger generations, one woman in three now lives her life without having children. The upward trend is a continuing one. By far, the major part of care for the elderly is still provided by members of their family and those members’ children. In future, the number of people requiring care who are childless and

**Figure XI. Simulations of the demographically induced rise in health-care expenditure and of the impact on health insurance contributions in the twenty-first century**



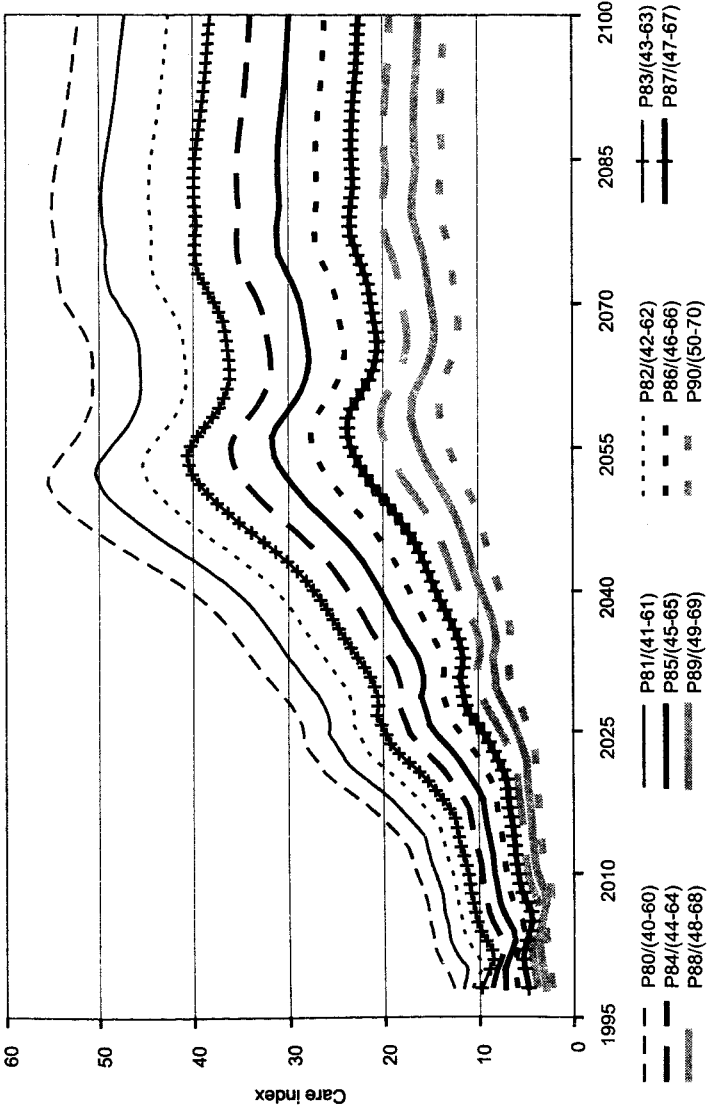




Source: Own calculations.

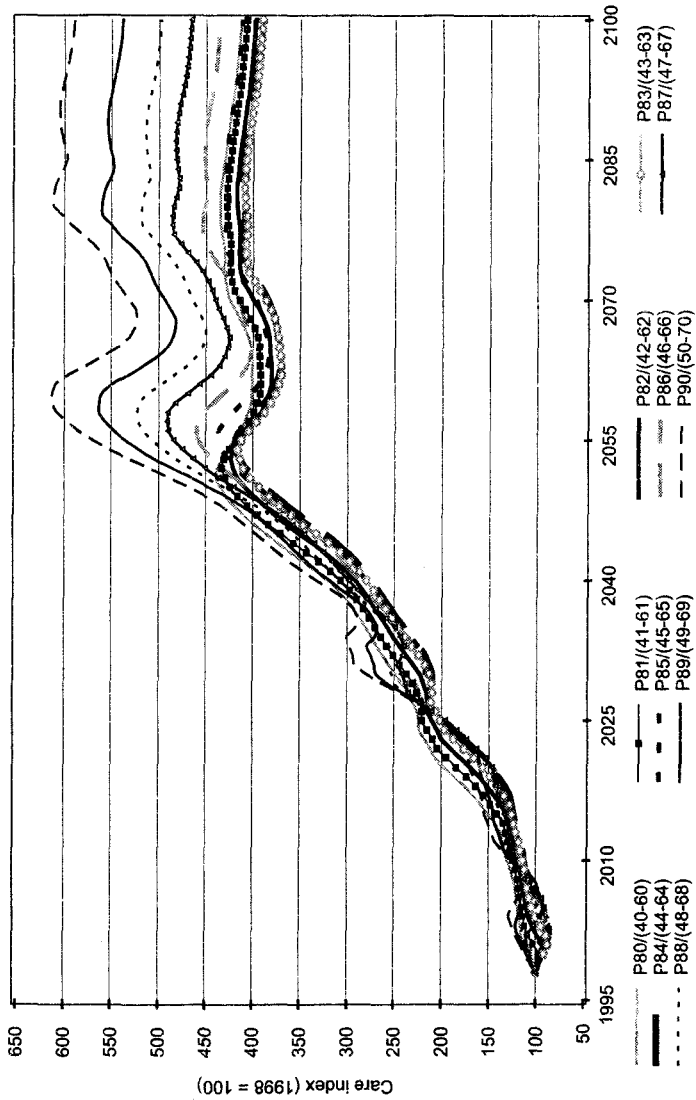
NOTE: Assumptions: Gradual increase in life expectancy from 73 to 81 years (males) and from 80 to 87 years (females) by 2080; TFR = 1.4; annual net immigration = 150,000.

Figure XII. Changes in the demographic senior citizens' care indices, using different delineation ages



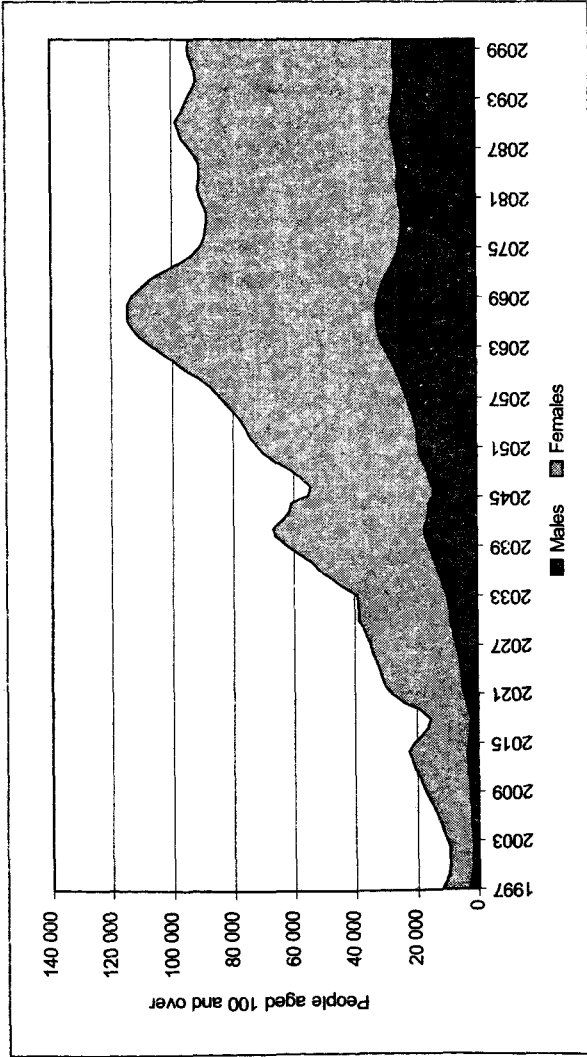
Source: H. Birg and E.-J. Flöthmann, "Demographische Projektionsrechnungen zur Rentenreform 2000" (report to the German Insurance Association (Gesamtverband der deutschen Versicherungswirtschaft)) (projection variant 5), Berlin, 1999.

**Figure XIII. Changes in the demographic senior citizens' care indices, using different delineation ages  
(all variants indexed to 1998 = 100)**



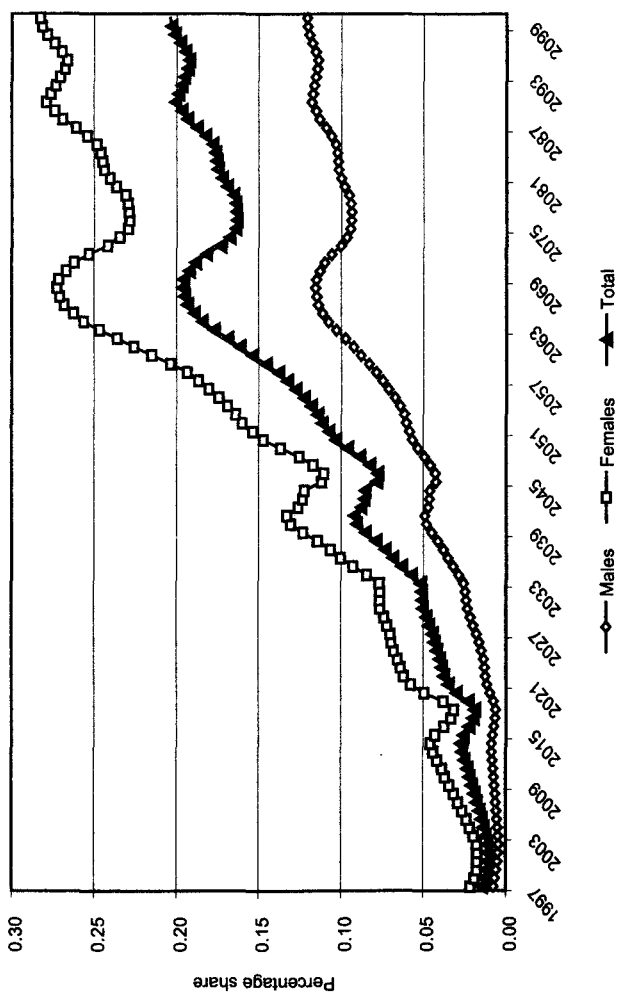
Source: H. Birg and E.-J. Flöhmann, "Demographische Projektionsrechnungen zur Rentenreform 2000" (report to the German Insurance Association (Gesamtverband der deutschen Versicherungswirtschaft) (projection variant 5), Berlin, 1999.

Figure XIV. Estimate of the future number of people aged 100 years or over in Germany  
(projection variant 5)



Source: H. Birg and others, *Simulationsrechnungen der Bevölkerungsentwicklung in den alten und neuen Bundesländern im 21. Jahrhundert* (Bielefeld, Germany, University of Bielefeld, 1999).

Figure XV. Estimate of the future share of the total population taken up by people aged 100 years or over in Germany (projection variant 5)



Source: H. Birg and others, *Simulationsrechnungen der Bevölkerungsentwicklung in den alten und neuen Bundesländern im 21. Jahrhundert* (Bielefeld, Germany, University of Bielefeld, 1999).

have to obtain their care outside the family will increase especially strongly. This raises a problem in that the principle of equity in relation to contributions paid will be breached unless contribution rates somehow take account of how many descendants people have and what part they will play in providing care.

## CONCLUSIONS

In the last three decades of the twentieth century, the worldwide decline in birth rates and increased life expectancy generated demographic ageing not only in the populations of industrialized countries, but in developing ones, too. The worldwide process of demographic ageing will continue in the twenty-first century. By mid-century, the ageing index in Germany will have doubled or trebled. This is largely attributable to the ever-decreasing numbers in the younger age cohorts, and due only secondarily to increasing life expectancy. Demographic ageing so thoroughly undermines the effectiveness of the statutory insurance system, including the solidarity between generations encapsulated in the pay-as-you-go method of financing State benefits, that it is becoming a matter of ever-growing urgency to develop other forces of cultural integration between younger and older generations as a substitute for the solidarity formerly underpinned by the population's demographic structure.

Yet in practice, the opposite trend is operating. Now that competition among economies predominates on a global scale and economic action in general is increasingly driven solely by the competitive principle, the link between economic competitors and their responsibility towards society, based on a principle of solidarity, is steadily on the wane. Indeed, there is even a tendency for the normal competitive principle to be perverted in the phenomenon of hyper-competition, in which cooperation and coexistence are no longer regarded as a worthy aim, but the destruction of a competitor's entire trading basis is so regarded. The demo-economic paradox of a declining number of live births per woman while the level of economic development and per capita incomes increase is one of the key consequences of this underlying trend.

Economic globalization leads to demographic destabilization, compelling drastic reforms to be made in statutory welfare insurance systems. Nor can the pressure for social reform exerted by demographic change be resisted by allowing high levels of immigration of well-qualified people. Indeed, large-scale, uncontrolled immigration of relatively unskilled people into Germany—representing several times the number of “permanent” immigrants to the United States of America per 1,000 of population (Organisation for Economic Co-operation and Development, 1997, p. 15)—has actually exacerbated the demographically driven problems by laying large additional burdens on the welfare State instead of helping to alleviate them.

In Germany, the “pact between the generations”—that is to say, the demographically underpinned basis of solidarity for the statutory social insurance system—has already been so critically weakened that the pay-as-you-go system of funding retirement pensions can now be maintained only with the aid of substantial grants out of general taxation to boost the revenue side. Without these subsidies, the current contribution rate would be 24 per cent, not 20 per

cent as it actually is. In future, the pay-as-you-go system will inevitably have to be supplemented by individual private pension plans, in other words, set up on a “fully funded” basis for each future pensioner. The investment yield inherent in such fully funded pensions will then be able to accompany (but not fully replace) the demographic guarantee of solidarity inherent in the pay-as-you-go system.

In the wake of globalization, national capital markets are increasingly merging together into a single world capital market, the main rationale of which is to maximize returns. Yet to seek to provide a secure living in old age on the strength of this risk-dependent principle of yield maximization, of all things, is a strategy destined to become all the more dangerous the more countries forfeit their national “sheltered areas” in the wake of globalization.

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