Speech by Federal Minister Dr. Thomas de Maizière,

Chief-of-Staff of the German Federal Chancellery

Mr Chairman, Mr Oswald, Mr Linssen, ladies and gentlemen,

You will all be familiar with the Chinese proverb:

“If you want a year of prosperity, sow corn. If you want ten years of prosperity, sow trees. If you want 100 years of prosperity, sow people.”

There have always been wise heads who appreciated the meaning of this proverb. But we do not always act accordingly. The demography of Europe is currently going through what may well be a historically unprecedented transformation. This is happening on a scale that is probably comparable with the changes that took place in Europe during the Thirty Years War. But this transformation is taking place very gradually and, it would appear, imperceptibly. I will begin with a few facts. I do not know whether Mr Linssen touched on them earlier. After all, much of this is already common knowledge. Happily, people in Europe are living longer than they used to. Not only that, for more than three decades, the birth rates in Europe have not been high enough to maintain its existing population. Europe is growing older and Europe is growing smaller. Europe is growing older because, according to expert forecasts, by 2050 there will be about 58 million more people over the age of 65. This will represent an increase of 77 percent compared to 2004. What is more, it is thought that the working-age population will have gone down by 48 million or 16 percent by that time. As a consequence, in 2050 there will be two people of working age for every person over the age of 65 – instead of the four-to-one ratio we have at the moment. In Germany, there will only be “one-and-a-half” workers having to support each retired person. Many people therefore speak of an aging society. I do not feel the German word for this is quite accurate: we say *Überalterung* – which literally means “over-aging” – and seems to suggest that we have too many old people. But we should be delighted that people are living longer. That is why the situation should actually be described with a word that does not really exist in German and I do not quite know how the interpreters will translate it. The word I am thinking of is *Unterjüngung* – which literally means “under-rejuvenation”. This suggests that we live not in an aging society, but in a society that is failing to produce enough young people. We have too few young people and not too many old people. It would not even be difficult to solve the problems we are facing as people get older if we had lots of young people and children at the same time. Those are the facts of the matter. Furthermore, Europe is growing smaller not so much because the population itself is falling, but relative to other parts of the world. Internationally, we are faced with a number of regions that are experiencing population growth – which is extraordinarily strong in some places. The proportion of Europeans in the world population is therefore set to fall further: From what is currently still a good 11 percent to an estimated 7 percent in 2050 – assuming that the world’s population will then be about 9 billion people. I was born in 1954 and I learned in school that the food supply for the world population would collapse if we had more than two billion people on Earth. It is true that hunger has not yet been defeated all around the world, but we do believe that, given changed or normal economic conditions, it will in fact be possible to feed the existing population and even a growing population. I am not attempting to play down the problem of feeding the world, but simply trying to give you some idea of how far off the mark forecasts can be: when I was young, we thought it was impossible to feed more than two billion people, yet the global population looks set to reach nine billion by 2050. This development will have an impact on almost every area of life and politics. Demographic changes are also shaking the foundations of our prosperity, restricting the potential for growth and imposing a growing burden on the public finances and welfare budgets. Not least, however, they also represent a challenge for the financial markets, to which you are going to be devoting special attention in your discussions. The overall prospects for economic growth are coming under pressure because, in the view of the Commission and the Member States, the supply of work and employment levels will start going down around the end of the next decade at the latest. By 2050, the number of people employed in Europe will have fallen by almost 5 percent. Growth will then primarily have to be achieved by means of additional labour productivity. For instance, one – admittedly hypothetical – scenario put forward by EU experts forecasts that annual per capita growth in the period from 2030 to 2050 will be 0.8 percentage points lower than today solely due to demographic developments. We do not know whether they are right. It is reminiscent of the well known witticism: Forecasts are hard to make – particularly when they are about the future. So I am a little suspicious of such projections, but it is certainly a calculation that is conclusive in its own terms. Mr Linssen has referred to the fact that considerable expenditure risks will arise for the public budgets due to age-related spending on pensions, health services and long-term care. According to the most recent estimates, if we continue with our current policies – and this is not a forecast, but an if-then statement –, if current trends continue as they are at present, the public budgets in the EU will have to allocate almost three-and-a-half percentage points of gross domestic product more to age-related expenditure by 2050. This does not relate to the EU budget, but all our budgets taken together – irrespective of the competences held by particular institutions. That would be equivalent to the public budgets growing by 10 percent. I do not think there is anywhere where such an expansion can be financed. After all, the financial markets too are affected by demographic change. Concerns are occasionally expressed that there could be massive disruption in future if people who have saved for their own pensions dispose of their assets once they have retired while subsequent generations fail to develop sufficient demand, but I feel these concerns are somewhat exaggerated. Nevertheless: In a population that is growing older and declining in numerical terms, people will save less and it will *a priori* be more difficult to exploit interesting investment opportunities than if we had a young, growing population – certainly within the EU. Furthermore, private pension provision is playing an ever greater role. What does this mean for the policy measures we should be implementing? To begin with, it has to be said quite soberly that politicians need to accept they can only exert a limited amount of influence in the face of these demographic developments. Firstly, most of the children in question have already been born or not born, so any attempts to influence the situation will only have an impact over the very long term, if we disregard for now the assumption that some of these problems can of course be solved by immigration. Secondly, there are no clear correlations between policy measures and the number of children people have. Apart – probably – from one, and that has rather worrying implications. There is a very long term tendency: the more prosperous a society becomes, the fewer children it has. This can, of course, not mean that we take the opposite approach, renouncing prosperity and giving up our efforts to increase prosperity in order to make people have more children again. Thirdly: there are relatively few concrete causal links between state policies and reproductive behaviour. There are possibly two remarkable exceptions – France and Sweden – where governments have encouraged people to have more children, but not actually succeeded in completely reversing the trend. Furthermore, we know that if parents want children, women or men or parents – I don't want to get into a discussion of family models at this point – that has a great deal to do with whether they feel confident about the future and less with the level of benefits they can expect to receive if they have a child. This does not mean I would argue for cuts to the benefits families receive because there is, in any case, not actually much point in making such cuts. We just have to be aware of the limited nature of what we are doing when we take action directly aimed at persuading people to have more children. Despite this, of course, we all have much to do, in our own countries and at the level of the European Union. In Germany, the Federal Government has taken a series of measures, most recently with its decision on "Retirement at 67", the introduction of a parental allowance and the funding of infrastructure measures, particularly in East Germany. In future, it will be necessary for measures to be integrated even more across discrete areas of policy and, finally, for all measures to be scrutinised as to their demographic sustainability. Because demographic change is affecting the whole of Europe, it is also necessary to approach these questions in a European context and, Mr Oswald, that is the purpose of this event, as I understand it. With its 2005 Green Paper and the subsequent documents, the Commission initiated an intensive dialogue between Europe and its Member States. Our discussion today is intended to have a particular focus on the public finances and financial markets. So I will make a couple of remarks about these issues. We have to organise the public finances on a viable basis. In this respect, I see three core tasks: the systematic consolidation of the public budgets; structural reforms, particularly in the pensions sector; and the further improvement of the conditions for growth and employment. The continued consolidation of the public budgets is necessary if we are to retain the capacity to take effective action despite the rising levels of spending that will be necessary in future – I have already spoken of what will have to be done if we are to ensure secure provision for old age. This is a field in which positive developments are taking place. With regard to the public deficits, I am glad to say that the situation in Europe has improved somewhat in the last year. From a German perspective, with a deficit of 1.7 percent of gross domestic product, we were able to stay clearly below the three percent ceiling set in the Maastricht Treaty for the first time since 2002. For 2007, the German Federal Government most recently reported an expected deficit of 1.2 percent of gross domestic product to Brussels. I hope that we will succeed in reducing this figure even further. We may then reckon with the formal closure of the deficit proceedings while Germany still holds the Council Presidency. However, we also know that we are in the lower third of the countries of the European Union as far as the cutting of public deficits is concerned. And we also know that this is essentially a cyclical success and not a structural success. As in Germany, financial balances are improving and levels of debt are going down at the European level too at the moment. Last year, the deficit ratio in the EU fell from 2.4 percent to 1.7 percent of gross domestic product, while the debt ratio went down from 62.9 percent to 61.7 percent. This is progress of a sort, but certainly not very much. Our efforts at consolidation must now be continued systematically. Only a few days ago, the Eurozone finance ministers agreed here in Berlin that they would seek to achieve their medium-term budgetary targets by 2010. For Germany, this will mean the reduction of the overall structural public deficit to zero percent. When I talk about the overall public deficit, I am referring not to the federal budget, nor the budgets of the Länder, Germany's constituent states, nor Germany's social insurance systems, but all three taken together. This was rather unclear in the press the following day.

Over the long term, however, budget consolidation will not be enough to ensure the viability of the public finances. In addition to this, structural reforms are necessary in order to limit any rises in age-related expenditure. The reform of the systems we use to provide for our old age will have a special role in this respect. A number of Member States have tackled such reforms successfully over the last few years. Throughout, it has to be said, the applause from their populations has been very unenthusiastic, because these measures are usually associated with cut-backs. In 2001, Germany was still expected to see a rise in public spending on pensions amounting to 5.5 percentage points of gross domestic product by 2050, but the most recent forecast, which dates from 2005, only foresees an increase of 1.7 percentage points. The pensions reform not factored into this figure will limit the increase in public spending on pensions even further. In its reforms, Germany is relying on working lives becoming longer and wider take-up of additional capital-funded pension schemes as it seeks to ensure the appropriateness and sustainability of its pensions provision for the future. Since 1995, we have managed to raise the average age at which people take their old-age pensions – not the legal age, but the actual age – by more than a year to 63.2 years. Our most recent pension reform has just passed through parliament. Between 2012 and 2029, the statutory pension age will be increased gradually from 65 to 67 years. Incidentally, the federal minister responsible, Franz Müntefering, celebrated his 67th birthday during the deliberations on this legislation. The raising of the statutory pension age has gone hand in hand with improvements in the employment opportunities for older workers. We have succeeded in markedly increasing the employment rate among older workers in Germany. I am confident that we will meet the EU’s target of 50 percent for the proportion of older workers in employment by 2010. To be honest, 50 percent is actually a pretty modest ambition. And this is not just a question of how we fund the systems that provide security in old age. The time is coming when, in a complicated society characterised by the division of labour, we will be forced to rely on the experience and practical knowledge of older people. Since the pension reform undertaken in 2001, Germany has also been encouraging its citizens to build up additional voluntary capital-funded pensions. More than three-quarters of German employees have now gained entitlements to additional provision in old age. I probably don’t need to say much in the present company about other aspects of the debate on growth and employment and the Lisbon Strategy. You are well aware of all these issues. Allow me instead to look at structural funding. Given the multifaceted nature of demographic change, we should not concentrate on isolated measures when we implement packages of this kind, but must respond adequately to the challenges we face in all fields and integrate funding programmes with one another in an appropriate fashion. In East Germany – as Mr Linssen has already mentioned – we experienced a fall in the birth rate of more than 50 percent within one or two years after 1990. By 1991, the number of births had collapsed, going down by more than 50 percent compared to 1989. In the mean time, the figure is rising slightly again, but it is still about 50 percent of the pre-unification level. As a result, schools are being closed and residential buildings demolished. In addition to this, the fall in the population has not been spread evenly, but is concentrated in certain areas. The population has gone down especially dramatically in places where there was once particularly great population growth to satisfy the requirements of certain industries – lignite mining, for instance. We have cities in Saxony that have lost half their population since 1990. If they demolish high rise buildings there, they have to be very careful about which buildings to knock down because otherwise they get problems with the sewerage systems. This example merely illustrates how we need to integrate funding measures and what a massive amount there is to be done. If our public finance and pension systems are restructured as a consequence of demographic change, this will have an impact on the private side of the economy through the financial markets. Since the 2001 pension reform – which I have already mentioned – eight million private pension plans have been set up in Germany and 17 million people have gained entitlements to company pensions – all within five years. Developments of this kind are underway throughout Europe and obviously have an impact on the capital markets as well. Even if savers rely on intermediaries such as banks and insurance companies, the funds they invest still ultimately flow onto the capital market. Unlike people covered by pay-as-you-go pension systems, those saving for their own pensions are directly exposed to the risks of the capital market. In view of these developments, stable financial markets are becoming more significant. At the same time, the expansion of capital-funded pensions is being accompanied by growing demand for an appropriate range of products. Yet financial market stability can, unfortunately, not mean an absence of risk. Ultimately, higher returns can only be earned over the long term by taking on higher risks. However, it is important that citizens are aware of these risks, and only enter into the kind of risks they are capable of coping with. On the one hand, this requires that consumers learn more about the financial basics they need to know in order to be able to pursue their investment goals more effectively on the market. On the other hand, the great majority of people saving for their pensions also need competent, unbiased advice if they are to be capable of making sensible decisions about the financial provision they make for their own future. I say this because, for instance, investment advisors are not members of a regulated profession in Germany. Pharmacist, doctor, lawyer or cabinet maker are all – if you like – regulated occupations. But anyone can call themselves an investment advisor. I think the statutory framework for the protection of investors in Europe is creating good conditions for action in this field. The Markets in Financial Instruments Directive (MiFID), which the financial institutions have to implement by November 2007, has further improved the environment for investors, and we are currently in the final stages of the deliberations on the relevant legislation. Lastly, with investor protection in mind, I would also like to mention our initiative to increase the transparency of hedge funds. It is true that private investors do not put their money directly into these investment vehicles, but some of it certainly flows in this direction via the institutional investors to whom they entrust their capital. I am, of course, aware of the positive aspects of hedge funds for the financial markets. However, in view of their enormous significance for financial market stability, I regard greater transparency about their activities to be indispensable. In this context, it is the declared aim of the German Federal Government to obtain a voluntary commitment from the sector. And if the 10 biggest funds in the world were prepared to give such a commitment, we would have an arrangement in place that covered 80 percent of the financial transactions controlled by companies of this type. Which, incidentally, also raises questions from the perspective of competition law. We hope we will achieve this goal of a voluntary commitment – the European finance ministers are in agreement on this point. And we also want to put it on the agenda for the G8 process, which will take place at Heiligendamm in Germany this year. Aside from these considerations of investor protection, we should not lose sight of the fact that, because the European financial markets have become more strongly integrated, we are already better equipped for the challenges of demographic change at a fundamental level. After all, larger, more liquid, more dynamic financial markets are most likely to offer opportunities for the efficient employment of capital and the hedging of individual risks. They also ensure the competitiveness of the European financial industry and the whole of Europe as a place to do business. However, for a Europe that – as I mentioned earlier – is becoming smaller in relative terms, it is not just the removal of internal barriers that is important. Closer integration with partners and markets outside the EU is also opening up new opportunities for the European financial markets. In particular, the USA and Europe have remained each others' most important trade and investment partners through to the present day. Our economic systems have proved to be highly successful; they still generate more than 60 percent of global social product and they are founded on the same shared values. And yet we are divided unnecessarily by very different regulatory approaches in many areas – including the financial markets. As is the case when it comes to accounting regulations, for instance. That is why we are so delighted that, following an initiative from the German Federal Chancellor, the summit meeting that is taking place in Washington between the European Union and the USA while we sit here now will lay the foundation stone for a European-Atlantic economic initiative intended to foster better cooperation on the regulation of the technical and other standards we need for our doings and dealings with one another. Ladies and gentlemen, I think it will have become clear from what Mr Linssen and I have said today that there are no simple answers to the challenges of demographic change and also that such answers will not just come from the state. However, there are plenty of fields in which we can address these challenges in appropriate ways. I am confident that this event today will make an important contribution, in part by enabling us to acquaint ourselves with different problems and the strategies being pursued to resolve them.

That is why I am so pleased that you have come to Berlin to take part in this conference. Thank you for your attention.