Speech by Dr Helmut Linssen, Chairman of the Finance Committee of the Bundesrat

Dear Mr Oswald, ladies and gentlemen, I am able to welcome (almost) all of you here today as my colleagues, since we all chair a finance committee. We had the opportunity yesterday evening to get to know one another a little, though by no means completely. Allow me therefore to tell you a little bit about my job, as my position is not typical for the member states of the European Union. I am a minister in the beautiful *Land* of North-Rhine Westphalia, and as such simultaneously hold the position of Chairman of the Finance Committee of the Bundesrat.

"Bundestag" and "Bundesrat" are words which are closely related, yet the difference between these two institutions in Germany could hardly be greater, as I would like to briefly illustrate to you now. As you know, the German Bundestag is the parliament in Germany which is directly elected by the people. Because Germany is a federal state comprising 16 *Länder*, or federal states, there is besides the Bundestag also the Bundesrat, which as the representation of the *Länder* is composed of the members of the *Land* governments. Through the Bundesrat, the *Länder* are able to play a part in the legislative and administrative activities of the federation and in matters relating to the European Union.

As is the case with any other parliament, the laborious day-to-day work, without which nothing happens in the plenary sessions of a parliament, is done in the committees. The Bundesrat has 16 committees, the most important of which – and how could we of all people think otherwise – is of course the Finance Committee.

This is an observation to which you will no doubt be receptive. Every law which is to have any financial implications has to pass through the Finance Committee of the Bundesrat, where the Finance Ministers of the *Länder*, all of which are represented on the Finance Committee, critically review it, suggest amendments, or even reject it.

Ladies and gentlemen, our conference today is concerned with the viability of public finances in the light of the challenges posed by demographic change. In my short welcoming address, I will limit myself to portraying to you how Germany's population is likely to develop and where I, as a finance politician, see the primary challenges of this demographic change.

The population forecasts for large areas of Europe do not look good. Let me use the example of Germany to point to two key changes which we will have to face up to in the future.

For one thing, the population will shrink. This is also something to which my colleague Mr Oswald referred. Indeed, this process is already fully underway. Since 2003, Germany has no longer been able to balance its rapidly growing deficit of births with net migration. If the current demographic trend continues, Germany's population will drop in size from close to 82.5 million in 2005 to around 69 to 74 million in 2050 – depending on which assumptions for birth rate, life expectancy and migration the calculation is based on.

The decline in population size in absolute terms is one of the major changes; the fundamental shift in the age structure of the population is the other. Three statistics can be used to highlight unequivocally the changes which will take place in the age structure in Germany: while 61% of the population were of working age, i.e. 20 to 65, in 2005, this proportion will fall to around 50% by the year 2050. Within this group, there will be a clear shift towards the older section of the population. The second point is that the number of children and young people under 20 will already by 2010 be almost 10% lower than today and will then continue to fall at a significant rate. And the third point concerns the fact that there is no end in sight to the rise in the numbers of people over 80 years of age: this figure will climb from almost four million in 2005 to ten million in the year 2050.

The key drivers of this development are an increased life expectancy and a declining birth rate. Put simply, the rise in life expectancy is responsible for our ageing population, while the low birth rate is the cause of the shrinking population. With each woman giving birth to approximately 1.4 children, Germany's birth rate is particularly low compared with other European countries. While the Scandinavian countries, France and Ireland all boast significantly higher birth rates, they nonetheless remain beneath the birth rate threshold of 2.1 which is deemed necessary to maintain a population balance or, if I may put it like this, to achieve a continuous "reproduction" of the population. Countries such as Greece, Spain, Italy, Latvia, Hungary and the Czech Republic now have a lower birth rate even than Germany, yet it is only in Germany that such a low birth rate has already been the norm for 30 years. Consequently, there has only been a two-thirds reproduction of the population through births in Germany, and this has been the case for an entire generation. My colleague Mr Oswald also made mention of this fact. In concrete terms, this means that, since 1975, 1,000 women have produced only 667 daughters who have reached reproductive age; assuming that the situation remains unchanged, they can only expect 445 granddaughters from these daughters, and only 297 great-granddaughters.

Ladies and gentlemen, I am a businessman by trade and have not spent much of my life looking at the science of demography. As I was preparing this speech, however, I realized that the compound interest effect, the dynamism of which can repeatedly startle even the most seasoned businessman, has a great deal of similarity with the demographic forecasts for Germany, though it works the other way round: the longer a low birth rate continues, i.e. the longer there is a decline in the number of women of child-bearing age, the greater will be the impact of the shrinking process and the harder it will be to reverse the trend!

I began my comments on demographic change by saying that the forecast population figures do not look good. I am happy to admit that the idea of an ageing and shrinking society does not provoke in me much in the way of euphoria. At the same time, however, I believe that one should refrain – especially as a finance politician – from making covert value judgments with respect to population development, especially since certain aspects of this development – like our increased life expectancy, for instance – can without doubt be regarded only as positive. As finance politicians we should perhaps focus more on identifying the specific and general challenges for finance policy which this process of demographic change entails.

The challenges for finance policy are manifold. It would be overly complicated both for me and for you to list them all in detail. Nevertheless, I would like to describe by way of examples some of the demographic challenges facing finance policy, challenges which are particularly relevant in a federal state like the Federal Republic of Germany.

Let us take the case of public sector personnel. In Germany, many public sector employees are paid out of the budgets of the *Länder* – this is something of which many people are not aware. Police officers, teachers, judges and tax inspectors are employed at state level rather than at federal level. As a result, personnel expenditure accounts for around 40% of the *Länder* budgets, while the Federation spends only 10% of its resources on its employees. If we take a look into the future, we will note with alarm that the *Länder* will soon be facing a huge wave of retirees for whom they have made either no provision at all or nothing like enough provision. For my home state of North-Rhine Westphalia, it is estimated that expenditure on pensions will almost double by 2028: in 2001 this figure was just €3.8 billion, while in 2028 it will have risen to around €7.2 billion.

Let us look, ladies and gentlemen, at another problem we face: what is a town to do if its dwindling population is causing a direct shortfall in income, yet the costs of its infrastructure continue to remain at the same level because the town is not able to adapt this infrastructure quickly enough to keep pace with the drop in population? This is a problem with which above all the local communities in the Ruhr area of North-Rhine Westphalia find themselves confronted. Likewise the East German states have had – and indeed are still having – problematic experiences of this nature.

Let me just touch briefly on one more aspect: expenditure on public health. One does not have to be an expert in health care to be able to predict that these costs will continue to rise sharply in a society which is growing older and older. A time bomb is ticking in our health insurance system which – even after all the various health care reforms that have been implemented – we still haven't been able to defuse.

It is obvious, ladies and gentlemen, that the demographic changes will have different effects on the various public budgets and systems of social insurance, and we will have to watch out that we do not create a situation in which the buck is simply passed from one area to another, without the problems actually being solved.

To conclude my welcoming remarks, I would like, disregarding for a moment all the complicated detailed questions, to draw your attention to what in my mind are the two central issues associated with demographic change. They are also relevant to finance policy: first, given the fact that we find ourselves in an aging society, what can we do to secure our current levels of prosperity? You could also call this a question of growth of national product. And second, how are we to solve the conflicts of distribution between young and old, between parents and the childless, without subjecting our society to the sort of test which might tear it apart?

Let me say just this much as regards the first question concerning the growth in national product: in Germany and Europe, we will only be able to maintain our prosperity if we undertake quite extraordinary efforts in the field of education, fully in line with the European Union's Lisbon Strategy! Within the framework of globalization and the increasing international distribution of labour that it entails, we must concentrate on innovative and highly productive activities – we will only achieve this if we make the necessary investments in our human capital.

I find the question of distribution far more difficult to answer. One thing, however, should be clear: we must already start initiating steps to consolidate our state finances and to reduce our national debt so that we can give future generations sufficient leeway to tackle their own challenges. And this is why this issue is so important. In Germany, we are currently discussing precisely this topic – something which is particularly well-known from the Swiss example – as part of our debate on stage 2 of the federalism reform. In other words, we need to apply the brakes with respect to debt; and what can we take in the way of preventive steps? It would be irresponsible simply to allow the national debt to mount up and up, thus throwing our unresolved problems at the feet of future generations!

Thank you very much for your attention, ladies and gentlemen. I look forward to an interesting and stimulating conference. Thank you.