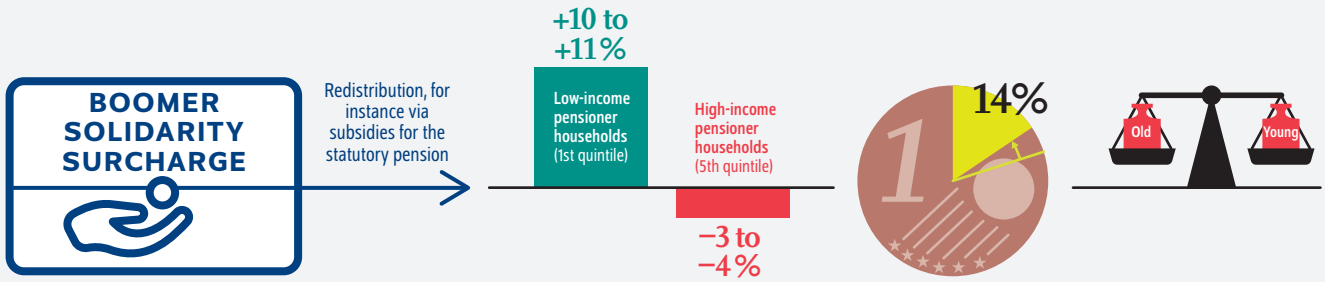
AT A GLANCE

The boomer solidarity surcharge: An important tool for stabilizing pensions without directly burdening younger generations

By Stefan Bach, Maximilian Blesch, Annica Gehlen, Johannes Geyer, Peter Haan, Stefan Klotz, and Bruno Veltri

- The pay-as-you-go pension system in Germany is increasingly under pressure as baby boomers enter retirement
- Study analyzes two reform options: redistribution of entitlements within the pension system and a special surcharge on all retirement income
- Both measures would improve the financial situation of low-income pensioners and reduce the risk of old-age poverty without directly burdening younger generations
- Intervening in pension entitlements is difficult for legal reasons and only possible in the long term; a focus only on statutory pensions does not go far enough
- A special surcharge on all retirement income (boomer solidarity surcharge) would have a much larger tax base and could be introduced in a relatively flexible way

A reform approach for pensions: High-income baby boomer pensioners are moderately taxed via a special surcharge to reduce old-age poverty



Special surcharge (progressive above a tax-free allowance) on all retirement income: Statutory, occupational, and private pensions, civil servants' pensions, other pension-related payments, optionally investment income

Net equivalized income of poor households would increase considerably

Old-age poverty would decline from 18 to nearly 14 percent

Younger generations would not be burdened directly, as redistribution would be among the retirees

Source: Microsimulation calculations using the GETTSIM model based on Socio-Economic Panel data (SOEP) from 2019.

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FROM THE AUTHORS

"Demographic change in Germany is a major task that requires monumental effort when it comes to the pension system. Pensions already account for 20 percent of the total federal budget. The boomer solidarity surcharge is a proposal that would make it possible for all generations to help tackle the task."

— Maximilian Blesch —

MEDIA

Audio Interview with Maximilian Blesch (in German)
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The boomer solidarity surcharge: An important tool for stabilizing pensions without directly burdening younger generations

By Stefan Bach, Maximilian Blesch, Annica Gehlen, Johannes Geyer, Peter Haan, Stefan Klotz, and Bruno Veltri

ABSTRACT

As the baby boomer generation enters retirement, the pay-as-you-go pension system in Germany is under an increasing amount of pressure. Relevant changes, in particular higher contribution rates or lower pension levels, are causing tension between generations: Either the financial burden on the younger generations is increased or the risk of insufficient pensions and old-age poverty for the elderly rises. This Weekly Report analyzes two different reform approaches that would result in redistribution within the older generations: A progressive devaluation of pension entitlements as proposed by the German Council of Economic Experts and the "boomer solidarity surcharge" suggested here, a special surcharge on all retirement income above a defined tax allowance. While redistribution within the pension insurance system would be a long-term process, the special surcharge could be implemented immediately. Both measures would improve the financial situation of low-income pensioner households without directly burdening the younger generations. If the special surcharge applies to all retirement and property income, a broad redistribution with only a moderate burden on higher income groups would be possible.

Demographic change in Germany is posing major challenges for the country's statutory pay-as-you-go pension system: Low birth rates over the past decades, rising life expectancy, and large baby boomer cohorts entering retirement are going to increase the old-age dependency ratio considerably.

With the cohorts born in the 1950s and 1960s now entering retirement, the number of new pensioners will grow significantly over the coming years. Due to their sheer size, the baby boomer cohorts are posing a major challenge for the financing of the pay-as-you-go system. The expected development of the old-age dependency ratio illustrates the impending ageing surge: According to the Federal Statistical Office, the ratio of retirement-age people (67 or older) to employment-age people (20- to 66-year-olds) will increase from 0.33 in 2025 to 0.42 in 2035.[1]

Thus, German pension policy must solve a difficult question: Who will carry the burden of the demographic change? Key parameters of pension policy are the contribution rate to the statutory pension system, the replacement rate, the retirement age, and the amount of federal subsidies to the public pension fund. However, an inter-generational conflict arises from making changes to these parameters: Lowering the replacement rate masks the risk of increases in old-age poverty,[2] while raising the contribution rate, higher tax financing, or raising the retirement age shifts the financial burden to the younger generations.

1 This surge is already visible in the retirement figures: While around 670,000 people entered retirement in 2010, over 950,000 entered retirement in 2023.

2 Hermann Buslei, Johannes Geyer, and Peter Haan, "Zur Entwicklung der Altersarmut bei Änderungen der Rentenanpassungsregeln und weiterer Reformen," *DIW Politikberatung kompakt* no. 198 (2023) (available online; accessed on July 1, 2025. This applies to all other online sources in this report unless stated otherwise); Hermann Buslei et al., "Das Rentenniveau spielt eine wesentliche Rolle für das Armutsrisiko im Alter," DIW *Wochenbericht* no. 21/22 (2019): 375–383 (in German; available online).

DOI: https://doi.org/10.18723/diw_dwr:2025-29-1

Box 1

Microsimulation and data

Net household income was calculated using the GETTSIM software. GETTSIM (German Taxes and Transfers SIMulator) is a program that was jointly developed by researchers at several research institutes and universities in Germany (IZA, DIW Berlin, ifo Institut, ZEW, University of Bonn, University of Kassel, LMU Munich, University of Mannheim, FU Berlin, and IAB). The program is an open-source project that is freely available to the public.

GETTSIM can be used for any household, employment, and income situation to simulate relevant parameters of the German tax and transfer system. This includes, for example, households' tax burden, individual social security contributions, and transfer payments such as unemployment, child benefits, housing benefits, social assistance (*Bürgergeld*), and pension entitlements.

For the analysis, it is assumed that households take full use of social transfers such as housing benefits. This can result in a slight overestimation of the household income of low earners.

The data for the calculations is from the Socio-Economic Panel (SOEP). The SOEP contains information about the income situation and household constellations of the German population. Using GETTSIM, households' tax burden and transfer payments are calculated and thus changes in pensioners' net household income can be simulated.

The calculations are based on the income and legal conditions of the year 2019. Any changes to the tax and transfer system following 2019 are not included in the analysis. This is a static simulation.

In its coalition agreement, the German federal government agreed to stabilize the net replacement rate[3] at 48 percent until 2031. At the same time, the statutory pension contribution rate should increase in the coming years to close the financing gap. The tax subsidy on pensions will also increase. This would shift the financial burden of the demographic change primarily to the younger generations currently of employment age.

In addition to these inter-generational distributional effects, there are also distributional effects within generations, i.e., between current pensioners. As life expectancy is systematically higher in Germany when income or pension entitlements are higher, there are redistributive effects from low to high pensions.[4] Current pension reform recommendations from the German Council of Economic Experts expand on these points: On the one hand, the increase in the contribution rate should be curbed by lowering the replacement rate, while on the other hand, the replacement rate for people with low retirement income should not decline too much. In its 2023/24 Annual Report, the German Council of Economic Experts discussed introducing progressive components into the statutory pension system:[5] For example, the proposed decline in the pension level for people with low pension entitlements at the cost of a stronger decrease for people with higher pensions would be smaller. This reform would lead to a previously unknown redistribution within a pension system and would be deviating from principle of contribution equivalence, which has so far been applied to the German public pension system.

One disadvantage of redistribution within the pension system would be that neither all types of income nor all people are a part of the system. A person receiving a high pension from the statutory pension system does not necessarily have a high household income and, conversely, a low pension does not always imply a low household income. Furthermore, the outdated corporatist traditions of the public pension system make redistribution difficult: While high and better-earning employees are insured in the statutory pension system compulsorily, civil servants and the self-employed are excluded, even if they have low incomes. This also applies to people insured by occupational pension providers for the self-employed or civil servants. A redistribution within the older generations through the tax system is thus a more targeted approach because it can include all retirement income and all retirees.[6]

This Weekly Report compares the distributional effects of a redistribution within the pension system (Scenario 1) with the distributional effects of a broad, additional taxation of all retirement income (boomer solidarity surcharge). This surcharge would be levied exclusively on retirement income so as to not burden the younger generations directly. Two variants of this special surcharge are analyzed here: In one, all retirement income from defined pension plans, i.e., statutory, occupational, and private pensions, civil servants' pensions, and other pensions, is taxed (Scenario 2a). In another, investment income[7] is also taxed if one household member is 65 or older (Scenario 2b). Labor income is not taxed in any scenario so as to avoid creating negative employment incentives.

3 The replacement rate (more precisely: pension rate before taxes according to Article 154, 3a of the SGB VI) is the ratio of a standarized pension (45 years of contributions based on an average income) and the average income of a current employee after social security contributions have been deducted.

4 Peter Haan, Daniel Kemptner, and Holger Lüthen, "Besserverdienende profitieren in der Rentenversicherung zunehmend von höherer Lebenserwartung," *DIW Wochenbericht* no. 23 (2019): 391–399 (in German; available online).

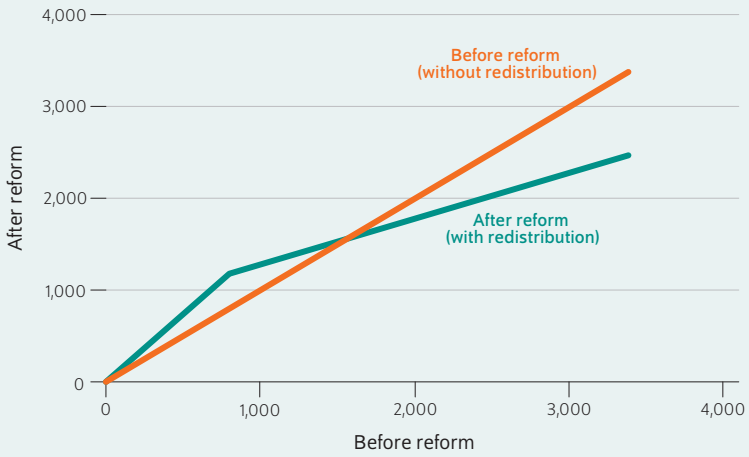
5 Cf. Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, "Wachstumsschwäche überwinden – In die Zukunft investieren," *Jahresgutachten 2023/24* (2023) (in German; available online).

6 Refer to Box 3 for more information.

7 For this purpose, personal data (for example, date of birth) would also have to be provided to the tax authorities when reporting the capital gains tax.

Figure 1

Pensions in Germany with and without redistribution within the pension system (Scenario 1)
In euros per month



Note: This figure shows pension payments, meaning gross pensions minus health and long-term care insurance payments.

Source: Authors' microsimulation calculations using the GETTSIM model based on Socio-Economic Panel Data (SOEP).

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When redistributing within the statutory pension system, low pensions are increased and high pensions are reduced.

Box 2

Revaluation and devaluation of pension entitlements (Scenario 1)

The model simulated here to revalue low statutory pension entitlements is based on the recommendation of the German Council of Economic Experts from 2023. The revaluation is calculated using the total pension points and is designed in such a way that the sum of the revaluations corresponds to the reduction in higher pensions, i.e., it can be implemented in a budget-neutral manner. To do so, all pension points earned up to a threshold of 20.8 are increased by 50 percent and the pension points above this threshold are reduced by 50 percent. Effectively, this would benefit all pensioners with total pension points of 41.6, while pensioners with higher entitlements lose out.

Some simplified assumptions must be made to implement this reform. First, the reform is simulated using data from 2019. Implementing the reform immediately would not be realistic, as the pension entitlements of the insured are legally theirs and revaluating current pensions would not be possible. Any significant intervention in the revaluation of existing pension entitlements would also be problematic. Thus, such a reform could only be implemented in the long term, for example by weighting newly earned entitlements with this new valuation scheme. Secondly, survivors' pensions will not be revaluated. Theoretically, the revaluation of pension entitlements would have a significant impact on these pensions. Third, behavioral effects are not simulated. The argument could be made that (insured) gainful employment could become less attractive above the threshold value due to the lower return on an employee's contributions. Fourth, all other existing regulations, such as the basic pension or the revaluation of pension entitlements during periods of simultaneous employment and childcare. Theoretically, the reform would have an impact on these regulations or make them superfluous.

All scenarios are designed to be budget neutral, meaning the additional tax revenue is redistributed within the older generation, making the scenarios comparable. Other scenarios that would redistribute more or less and/or are not budget neutral are possible. There are also scenarios that differ in the use of the additional revenue. The approach could be made more targeted by reviewing income, as is done for the *Grundrente*, or by using the funds to stabilize the contributions to pension insurance. These alternative scenarios are not analyzed in this Weekly Report.

Our analysis is based on microsimulation calculations using the open-source model GETTSIM (Box 1) and Socio-Economic Panel (SOEP) data.[8] We do not consider behavioral adjustments from households in terms of employment or savings in the analysis.[9]

Redistribution in the pension insurance system reduces old-age poverty and barely burdens high earners

The simulated redistribution within the statutory pension system (Scenario 1) explicitly deviates from principle of contribution equivalence, in which the paid contributions and individual pension entitlements are closely linked. This should, similar to the income tax, integrate comprehensive and progressive components into the statutory pension system. In principle, this could also be applied to the payment of pension contributions and the associated pay-out of pension entitlements.[10] The focus of this Weekly Report, however, is on redistribution within the current older generations.

One major issue with a redistribution within the statutory pension system is that cutting existing pensions is neither reasonable nor legally feasible.[11] Thus, the reform could only apply to future pensions in the long term. A simplified

8 The Socio-Economic Panel (SOEP) is a representative and multidisciplinary household survey. Cf. Jan Goebel et al., "The German Socio-Economic Panel (SOEP)," *Journal of Economics and Statistics* 239, no. 2 (2019): 345-360 (doi:10.1515/jbnst-2018-0022).

9 Potential effects of a redistribution in the pension insurance system and a boomer solidarity surcharge are discussed in the conclusion of this Weekly Report.

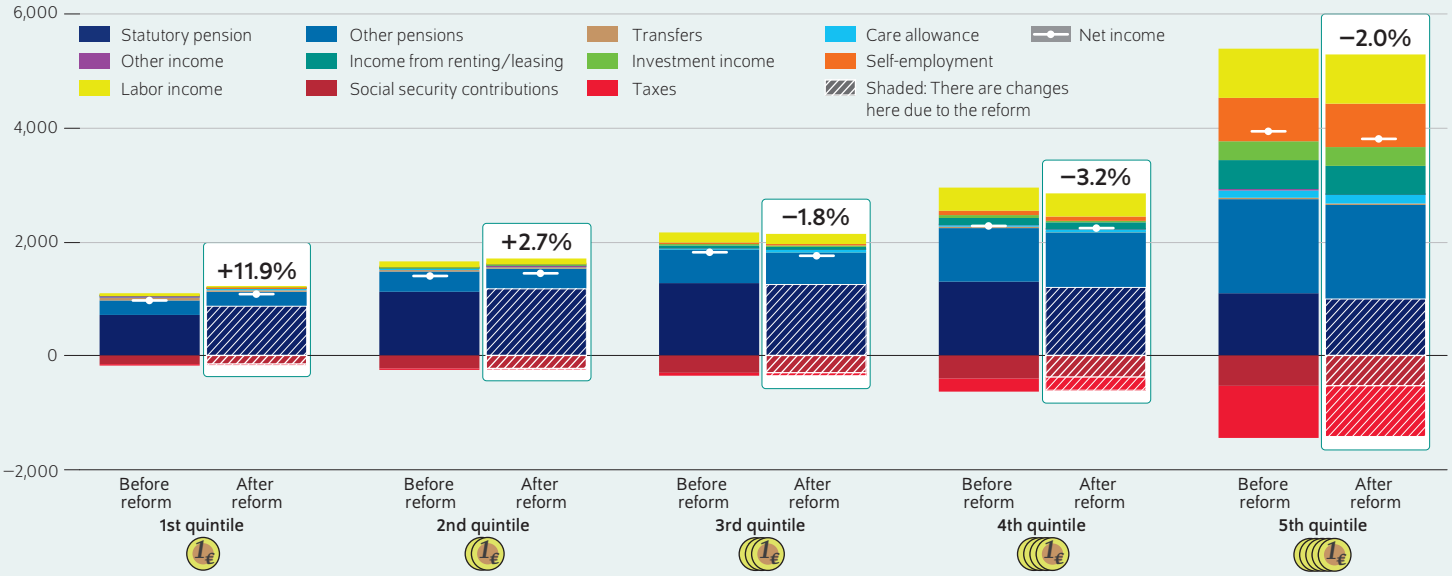
10 For example, this is currently applied to midijobs. The basic pension (*Grundrente*) would also be an example of a revaluation, although not until after the beginning of retirement.

11 Apart from legal concerns, this move would be problematic, as reducing current pensions, a key source of income in old age, would seriously undermine confidence in the welfare state.

Figure 2

Equivalized disposable income of pensioner households before and after redistribution within the pension system (Scenario 1)

In euros per month



Note: Pensioner households are a household in which at least one person is over the age of 65. The monthly equivalized disposable income is calculated using the net disposable household income (after taxes, including social transfers) that was equivalence weighted using the modified OECD scale.

Source: Authors' microsimulation calculations using the GETTSIM model based on Socio-Economic Panel Data (SOEP).

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The lowest-income pensioner households would be in a significantly better position than currently if there were a redistribution within the statutory pension system.

assumption is made in the simulation that the pension entitlements of all existing pensioners are newly revaluated at the beginning of retirement, a deviation from the current regulations.[12] This scenario is based on the proposal by the German Council of Economic Experts in their 2023/24 Annual Report (Box 2).[13] In this scenario, pension points, from which pension entitlements are calculated, are weighted with a factor of 1.5 below a selected threshold value, while pension points above the selected threshold value are weighted with a factor of 0.5 (Figure 1).[14] This results in an increase in low pension entitlements and a decrease in high pension entitlements.[15] The threshold for the redistribution of pension entitlements is selected so that the resulting changes are budget neutral from a fiscal standpoint. For example, if high pension entitlements are reduced, this results in tax losses from higher income brackets. To keep the national budget unchanged as a whole, these losses must be compensated for in other areas of the income distribution. In scenario 1, only statutory retirement pensions are reweighted. Theoretically, such a reform would also have an impact on survivors' pensions, but these pensions are not included in the analysis.

The threshold for redistribution is 20.8 pension points (Figure 1), meaning that pensioners with 41.6 pension points[16] or more in the progressive scenario receive a smaller pension than they currently do, while the pension of all pensioners with less than 41.6 pension points would increase. This strong progression with a marginal tax burden of around 50 percent is in accordance with the proposal by the German Council of Economic Experts.

With the calculated changes to the pension entitlements, we are able to determine the effects on the disposable income of pensioner households as well as the risk of old-age poverty rate in Germany. For households in the bottom income quintile (the bottom 20 percent), the statutory pension makes up an average of 70.3 percent of their disposable income (Figure 2). Households in this quintile rarely have other significant sources of income. Other pensions, such as civil servants' pensions or occupational pensions, make up an average of 19.7 percent of the net equivalized income, with occupational pensions only consisting of a small share. The bottom quintile would thus benefit significantly from a redistribution

12 This is a static simulation that does not include long-term behavioral adjustments.

13 Cf. Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, "Wachstumsschwäche überwinden."

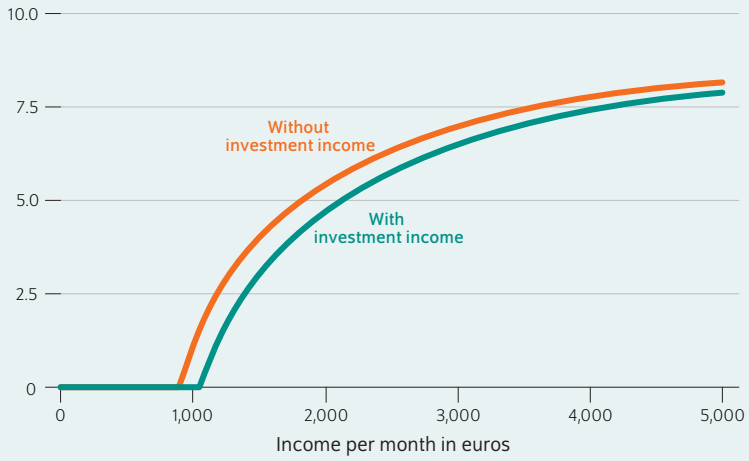
14 In the simulation, the total sum of pension points is used for the revaluation. In practice, however, it is worth considering removing pre-existing redistributive elements, such as the basic pension supplement or pension points for childcare periods.

15 This would benefit significantly more people than the basic pension, as the redistribution criterion is different (no insurance requirements) and no income test is performed.

16 This corresponds to a standard pension of 1,751 euros in 2025.

Figure 3

Boomer solidarity surcharge on retirement income (Scenarios 2a and 2b)
Average tax rate in percent



Source: Authors' microsimulation calculations using the GETTSIM model based on Socio-Economic Panel Data (SOEP).

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The boomer solidarity surcharge would be levied on all retirement income after deducting an allowance.

of statutory pension entitlements. The equivalized net disposable income for these households would increase by nearly 12 percent (Figure 2). This includes a 4.5-percentage-point lower (13.8 instead of 18.3 percent) risk-of-poverty rate for the population 65 and older.[17]

The top income quintiles (third, fourth, and fifth) carry the tax burden: The net equivalized income declines for the fourth income quintile by a good three percent and by nearly two percent for both the third and fifth quintiles each.

The observed redistribution would thus only be progressive up to the fourth income quintile for the household income distribution. The smaller impact on the top quintile could be explained by the fact that the statutory pension for these households is a comparatively small source of income, making up only 26.3 percent of their income. Many households in this quintile receive income from employment, investments, and/or alternative pension schemes, which would not be affected by a redistribution within the statutory pension system. Furthermore, many households in this quintile receive a small statutory pension, meaning they would benefit from a redistribution.

Focus on statutory pension ignores income situation of many well-off households

One disadvantage of a redistribution within the statutory pension is that the approach is not targeted, as it neglects important aspects of the income distribution in Germany. A systematic redistribution should also consider other components of the household incomes of pensioners, such as occupational or private pensions as well as pension systems existing alongside the statutory pension, such as civil servants' pensions and occupational pension providers for the self-employed. One possibility would be to increase the income tax to finance an increase in the tax subsidy for pensions. However, this would primarily affect the younger generation and exacerbate negative employment incentives.

Therefore, a better option would be a solidarity surcharge (referred to here as the boomer solidarity surcharge) on all retirement income that would apply to all households with such income (Box 3). In addition, investment income from pensioner households could be included, as this income often functions as a pension in old age (Figure 3). To compare the distributional effects of such a surcharge with those of a redistribution within the pension system, the surcharge is calculated so that it generates the amount of revenue that is required to improve lower statutory pensions through a redistribution in the pension system. Alternatively, it would also be possible to expand the group of beneficiaries beyond those that receive a public pension so that all low-income households benefit from the redistribution. For better comparability, the variant here only applies to households with low statutory pension income.

Two scenarios are analyzed: The first scenario (2a) only includes retirement income from defined pension schemes. In the second scenario (2b), investment income is also subject to the surcharge.[18] Earned income is not taxed in either scenario. Through a tax-free allowance, the boomer solidarity surcharge has a progressive effect. Retirement income above the tax-free allowance threshold of 1,048 euros per month (Scenario 2a) or 902 euros (Scenario 2b) is taxed proportionally at ten percent.

Boomer solidarity surcharge burdens middle income groups less

The boomer solidarity surcharge on all retirement income (Scenario 2a) burdens the top (third, fourth, and fifth) quintile. Retirement income other than the statutory pension is more important for these households, making up around 37 percent of their average household income. The equivalized net disposable income in the top quintile falls by nearly three percent in the calculated scenarios (Figure 4, top). Compared to the first scenario in which redistribution only

17 It is a question of policy whether the additional funds should be used primarily to reduce old-age poverty. The additional funds could instead be used to stabilize the pension insurance contributions, for example.

18 While income from renting and leasing must be declared, income from capital assets does not need to be declared due to the withholding tax (for more, see Box 3). In these cases, the boomer solidarity surcharge could be levied as a flat-rate surcharge as a part of the withholding tax, with the option of assessment.

Box 3

Special solidarity surcharge on retirement income (Scenario 2)

In this scenario, the German federal government levies a special surcharge on all retirement income as defined in the Income Tax Act (*Einkommensteuergesetz*, EStG). This surcharge is outside the tax system and the constitutional rules governing public finance (section 104a of the Basic Law). Legislative competence is based on the responsibility of the federal government for social insurance (section 74, paragraph 1, no. 12 of the Basic Law). The revenue from this surcharge does not flow into the general federal budget, but rather into a special fund that is created for the redistribution of retirement income and may only be used for this purpose. This way, subsidies to the statutory pension insurance providers and, if applicable, to the civil servant pension providers or the occupational pension schemes could be funded, insofar as low retirement income is to be topped up in these systems.

The special surcharge is levied on all retirement income as defined in the Personal Income Tax Act (EStG):

- Life annuities and other benefits as defined in section 22, no. 1, sentence 3 a) of the EStG, i.e., pensions from statutory pension insurance schemes, agricultural pension schemes, occupational pension schemes for the self-employed, "Rürup pensions," other occupational and private pensions, and accident pensions;
- Riester pensions as defined in section 22, no. 5 of the EStG;
- Pension payments as defined in section 19, paragraph 2, sentence 2 of the EtSG, i.e., pensions in accordance with civil service regulations as well as pensions from previous employment relationships, for example for managers and senior executives or company pension schemes.

Survivors' pensions as well as reduced earning capacity and disability pensions are also included in the retirement income that would be taxed. Optionally, older taxpayers' investment income could also be taxed, as private assets are in a close substitution relationship with defined pension plans. This applies to income from capital assets according to section 20 of the EStG as well as income from renting and leasing according to section 21 of the EStG. An age limit, such as the retirement age or the age at the time a person begins receiving retirement pay, would need to be introduced.

The implicit real return on owner-occupied residential property (imputed rent) cannot be included, as it is not recorded for tax purposes. Determining these for the special surcharge would mean a lot of bureaucracy. Likewise, passive income cannot be recognized as part of entrepreneurial income, as the scope of the person's employment at their company would need to be determined. This unequal treatment must be tolerated.

A tax-free allowance is deducted from the total taxable income. In this study, the income above the tax-free threshold is subject to a proportional tax rate of ten percent. A progressive tax rate would also be possible.

In this study, the special surcharge on retirement income is levied individually. Alternatively, the surcharge could be levied by household, in particular for married couples and life partners. This applies analogously to the progressive pension with revaluation of pension entitlements. Revaluating by individuals would mean that partners of high-earners with low retirement income would benefit from the revaluation of pensions despite the fact that their household has a high total income. This is an issue known from the basic pension scheme. A further possibility would be pension splitting, which is taken into account in the redistribution.

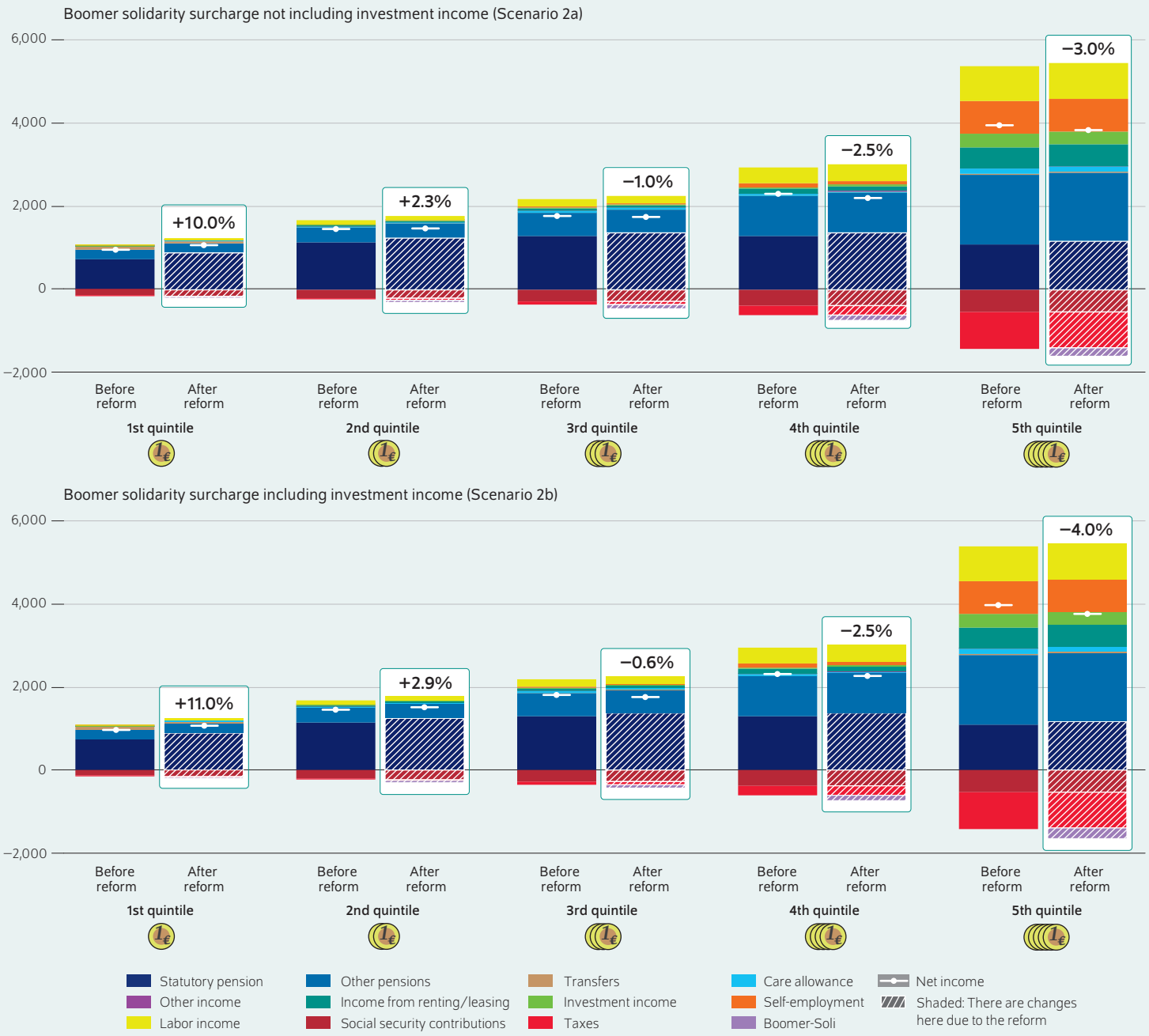
The special surcharge on retirement income could be processed with minimal bureaucracy as part of the income tax. In the vast majority of cases, higher retirement income is assessed for income tax, so older taxpayers would not incur any additional compliance costs. Only in some cases would income need to be assessed separately. As there are extensive reporting systems for retirement income for insurance companies and pension institutions, this information is available to the tax authorities. In general, income from renting and leasing must be declared. Income from capital assets, however, must be declared separately if it is not declared in the income tax return. Due to the withholding tax, this is not mandatory, even for high investment income. In these cases, a flat-rate special surcharge could be levied as a part of the of the withholding tax for older taxpayers, with the option of a separate assessment.

As the special surcharge on retirement income is not levied under the constitutional rules governing public finance or as a part of the tax system, the state tax authorities will be tasked with levying it. This could be decided via federal legislation with the approval of the *Bundesrat*. Alternatively, the surcharge could be arranged to be levied as a part of a "borrowed administration" arrangement from the federal government through state treaties or administrative agreements. The federal states should be remunerated for their services with a flat-rate administrative fee for their work, for example amounting to two percent of the revenue, similar to the church tax.

occurs within the pension system, these households carry 50 percent more of the redistribution burden. The burden on the middle quintile is halved compared to the first scenario. In contrast, the relief for households in the two bottom quintiles is comparable with redistribution within the pension system. However, minimal differences are possible, as the boomer solidary surcharge is levied on low-earning households in some cases. The risk-of-poverty rate for the population aged 65 and older declines by one quarter (4.4 percentage points), similarly to the first scenario.

Figure 4

Equivalized disposable incomes of pensioner households before and after introduction of a boomer solidarity surcharge (Scenarios 2a and 2b)
In euros per month



Note: Pensioner households are a household in which at least one person is over the age of 65. The monthly equivalized disposable income is calculated using the net disposable household income (after taxes, including social transfers) that was equivalence weighted using the modified OECD scale.

Source: Authors' microsimulation calculations using the GETTSIM model based on Socio-Economic Panel Data (SOEP).

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In the scenario including investment income, the redistributive effects of the boomer solidarity surcharge would be more pronounced.

Including investment income increases redistributive effects

The boomer solidarity surcharge includes income sources beyond retirement income. For households in the top quintile of the income distribution, statutory and other pensions only make up around 64 percent of the average equivalized income, while this share is over 80 percent for the middle quintiles and over 90 percent for the two bottom quintiles. The share is so low for the top quintile, because among other things, well-off pensioner households tend to still be working or have income from self-employment. At the same time, a large share of the income of households in the top quintile comes from investment income as well as renting and leasing.

If the boomer solidarity surcharge also applied to investment income, the burden on the top quintile would increase by one percentage point to a good four percent (Figure 4, bottom). There is hardly any change to the burden on households in the fourth quintile, while it declines in the third quintile due to the high tax-free allowance. Compared to the second scenario, low-income households have 0.7 to 0.9 percentage points more relief. Generally, these households do not have investment income, but also benefit from the higher tax-free allowance. The decline in the risk-of-poverty rate for pensioner households to 13.6 percent is somewhat stronger than in the first two scenarios.

Conclusion: A boomer solidarity surcharge more effective than redistribution within the statutory pension scheme

Despite reforms, the pension policy of the past years has overlooked many aspects. In particular, no reserves were built up to lessen the upcoming financial burden due to the demographic change. It would have made sense to have the baby boomer cohorts, who worked for longer, participate earlier and more in the financing of the pension system.[19] Thus, the question of how to fairly and efficiently distribute this unavoidable burden is high on the agenda.

Further decreasing the replacement rate is often mentioned in the current debate on the future of the statutory pension insurance system. While this would reduce the amount of money spent on pensions, it would increase the risk of poverty for the elderly. The German Council of Economic Experts has discussed a more progressive redesign of the pension formula, keeping this effect in mind. However, total pension points are not a good indicator for low household income. In addition, such a far-reaching intervention in pension entitlements would only be possible in the long term for legal reasons. Thus, this is not a solution to the major challenges that the pension system will face in the next two decades.

The boomer solidarity surcharge analyzed here, a special tax on all retirement income, avoids these problems. All older, high-income pensioners would contribute to the redistribution. Investment income can also be taxed, as tax interventions in income and assets are generally permissible if they are objectively justified. The significantly larger tax base makes lower marginal tax rates possible, which would make the intervention in the pension entitlements of well-off pensioners less significant. Advantageously, a boomer solidarity surcharge would also be easier to repeal in the future, for example once the financial situation of the pension insurance scheme improves.

The scenarios analyzed here are possible variants of redistribution within the pension system; the exact implementation depends on the political goals. Other variants are also possible: On the revenue side, for example, the special surcharge could be more progressive or on the expenditure side, an income test could be performed or low pensions in other schemes could be increased. A scenario in which the future increase in the contribution rate for the younger generations would be less severe, and thus a larger share of the financing costs would be borne by higher-earning pensioners. However, there would still be the previously mentioned advantages of a special tax compared to a redistribution within the pension system in these variants, and this would not directly burden the younger generations compared to a general increase in the income tax.

Possible incentive effects during the employment phase must be taken into account for all variants of a special tax or redistribution within the pension system. However, earned income is not taxed directly. Nevertheless, since pension entitlements are either redistributed or the special surcharge reduces retirement income, workers face an intertemporal burden. This tends to provoke avoidance reactions and can reduce labor supply during working life. As the tax base for the boomer solidarity surcharge is considerably larger and all sources of retirement income are affected, the implicit intertemporal marginal tax burden on labor income would be lower than if there were a redistribution solely within the statutory pension system. In contrast, other retirement income is taxed. This would reduce incentives for private retirement provision and savings, particularly if investment income is also taxed.

A progressive pension formula and the boomer solidarity surcharge would be an implicit wealth tax on the assets of high and better-earners. Although the surcharge would be unavoidable, high-income pensioners are likely to resist this "expropriation" if they do not agree with the idea of solidarity within their generation and providing relief for the younger generations. However, it must be emphasized that any reduction in the replacement rate would have such effects. With the boomer solidarity surcharge, however, these tax burdens would be distributed more fairly. Increases in

19 In its 2013 pension reform plan, for example, the German Trade Union Confederation (DGB) advocated an early increase in the contribution rate so as to spread the burden over more cohorts, cf. Deutscher Gewerkschaftsbund, *Heute die Rente von morgen sichern: Das DGB-Rentenkonzept 2013* (2013) (in German; available online). Monika Schnitzer, a member of the German Council of Economic Experts, recommended a similar idea and supported an increase in the contribution rate to get the baby boomer cohorts contributing to financing, cf. n-tv, "Wirtschaftsweise: Müssen Baby-Boomer zur Kasse bitten," January 9, 2023 (in German; available online).

life expectancy in Germany could be an additional justification for the surcharge.

Policymakers will have to implement bold and far-reaching pension reforms in the coming years. Maintaining the security provided by pensions, guaranteeing a good standard of living in old age, and simultaneously financing it all poses major financial challenges. Various reform steps are necessary to do so, and a special surcharge on all retirement income could be an important component of such reforms.

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