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Creating a Shareholder Culture and the Germans' Treasure

With his proposal to promote equity-based saving, the German conservative politician Friedrich Merz has placed an important topic on the agenda. Germans are busy saving, but a large part of it ends up in their savings accounts. In times of zero interest this is not a good investment. Demographic ageing means that pay-as-you-go pensions are falling. The resulting pension shortfall is pretty hard to fill with savings at zero interest rates. Shares offer a higher yield in the medium term.

To address this Friedrich Merz wants to reduce the tax burden on equity investments. Does that make sense? In a non-paternalistic society, it may well be one of the government's tasks to oblige all citizens to provide for their own pensions to some extent. Which investment portfolio citizens use to achieve this, however, should be up to them. Income tax should neither discriminate against, nor promote equity investment. In fact, shares are discriminated against in most tax systems. Debt financing is more attractive from a tax point of view than equity financing, because debt interest is tax-deductible for companies, whereas dividends are not. At least in the German tax system, interest and dividends are treated equally once paid out to their recipients. It would make sense to eliminate this discrimination.

However, such a reform would probably make little difference to the retirement provisions of large swathes of the population. This kind of tax relief for shareholders would mainly benefit high-income individuals in the upper tax brackets who currently own shares. Insufficient pension provision, by contrast, is primarily a problem for middle and low income groups.

Instead of trying to control its citizens' portfolio, the government should start by putting its own house in order. The public sector has considerable potential to make its asset portfolio more profitable in the interest of citizens. Smart private investors are currently using the low-interest phase to borrow cheaply and invest in real estate or stocks. The German entrepreneur Lutz Helmig recently suggested that the German state should do the same by setting up a 'German Citizen Fund'. Germany has the advantage of enjoying a high credit rating thanks to its sound finances. German government bonds are seen as the safest security in the Eurozone, and the German state can borrow money at almost zero interest rates. Germany has no oil reserves, but its high credit rating is equally valuable. It can be seen as something the Germans' national treasure. In 2019, the German public debt ratio will fall below the 60 percent mark. Instead of continuing to pay off debt afterwards, a certain amount of new debt and budget surpluses could be used to create a German citizens' fund. This fund would globally diversify its assets and invest them in equities and other attractive investments.

What returns was the fund able to generate? The Norwegian sovereign wealth fund, which invests the country's oil revenues worldwide, has generated an average return of 6 percent since 1998. Assume that the German sovereign wealth fund will generate 5 percent in the future and will pay one percent on its debt. If the fund invests 1 percent of gross domestic product each year of which 0.5 percent - currently around 17 billion euros - is financed through tax revenues and the rest via debt, it would acquire net assets worth around 43 percent of gross domestic product by 2050. Every citizen aged 20+ would become a member of the Civic Fund, would receive regular statements on the value of her own share and would be paid out at the age of 67. Today's 35 years-olds would receive approximately 41,200 euros by 2050. If one could extend the annual debt to 1% of GDP, provided that this is compatible with the debt brake in the Basic Law, this figure would rise to 53,700 euros.

Many people are skeptical about the idea of allowing politicians to incur debts in order to build up assets for citizens. It is, however, possible to take legal precautions to deprive to day-to-day politics of access to the fund. It could be managed by the Bundesbank. The citizens' fund offers a way - especially for people with low incomes - to significantly improve their, in many cases, meager statutory pensions without forcing them to save more themselves. We should seize this opportunity.

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Source: ifo Institute.