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A Swedish-style pension for Germany

As part of a comprehensive reform package, Germany's Pension Commission proposes a mandatory funded component based on Sweden's model. It could raise future pensions, but success depends on low costs, political independence and implementation of the package as a whole.

On 23 June 2026, after 24 weeks of work, the German Pension Commission submitted its final report to Chancellor Friedrich Merz, setting out 33 recommendations for pension reform.

Germany's demographic challenge

Like many other developed countries, Germany faces substantial demographic pressure. The baby-boom generation is retiring, birth rates are low and life expectancy is rising. This will worsen the ratio of contributors to pensioners and place an increasing burden on the statutory pay-as-you-go pension system. Against this background, the governing coalition of the centre-right CDU/CSU and the centre-left SPD appointed the Commission to develop a sustainable reform programme.

The proposed reform covers all three pillars of retirement provision but focuses on the statutory first pillar. It is designed as a comprehensive package that asks all groups to contribute while stabilising the pension system over the long term.

The Commission recommends linking the retirement age to life expectancy, gradually ending early retirement without benefit reductions, and restoring the sustainability factor, which moderates pension increases as the population ages. It also proposes extending statutory pension insurance to the self-employed and, eventually, civil servants.

These measures would help contain the projected increase in the contribution rate. It currently stands at 18.6 per cent, financed equally by employees and employers, and is expected to rise to slightly above 21 per cent by 2040 in the absence of reform. Depending on how fully and quickly the measures are implemented, the increase could be reduced by up to 1 percentage point.

Without reform, the pension level is also projected to decline. The reform measures would moderate this decline. Raising the retirement age would help stabilize the pension level by keeping more people in employment and contributing to the system for longer, while reducing the number of pensioners. This effect would be partly offset by the sustainability factor, which slows pension growth as the ratio of pensioners to contributors deteriorates.

Overall, the reforms would curb rising contribution rates and falling pension levels, but they would not be able to reverse these trends entirely. In particular, reforms to the pay-as-you-go system alone offer little prospect of increasing statutory pension levels. This unpromising outlook motivated the Commission's proposal to strengthen funded provision, especially within the statutory first pillar.

A Swedish model for Germany

Germany is starting from a low level. According to the OECD's Pensions at a Glance 2025, assets earmarked for retirement equal only 6.4 per cent of GDP in Germany and 11.7 per cent in Italy, compared with 115.8 per cent in Sweden and 260.4 per cent in Denmark.

As its central innovation, the Commission recommends introducing a mandatory funded component (*Kapitalrente*) within the statutory first pillar. The proposal draws on Sweden's premium pension system.

The funded component would complement the pay-as-you-go system by generating returns that are less dependent on Germany's demographic and economic development. To achieve this diversification, assets should be invested globally across a broad range of asset classes and sectors, rather than being concentrated in the German economy. This would give broader sections of the population access to global capital-market returns while also helping to deepen European capital markets.

Getting the design right

Germany's experience with funded pensions has been mixed, however. The voluntary, publicly subsidised Riester pension suffered from serious design flaws. High costs and the guarantee of nominal contributions limited investment in assets with higher expected returns. Any new scheme – especially if participation is compulsory – must learn from these shortcomings.

The Commission proposes an additional contribution rate of 2 per cent of gross earnings, shared equally between employers and employees. In the medium term, measures such as a higher retirement age, the restoration of the sustainability factor and the inclusion of the self-employed in statutory pension insurance would offset part of the increase.

The contributions would be paid into individual funded accounts. Contributors would have the choice between a publicly managed, internationally competitive fund and a limited number of certified private funds subject to the same strict criteria. The Commission expects the resulting returns to raise first-pillar pensions over the long term.

Several safeguards are essential. The assets must be protected from diversion to other purposes, including political projects. Investment decisions must be made by professionals and remain independent of political influence. Assets should be broadly diversified to limit investment risks.

Costs are equally important. The Commission proposes a particularly ambitious benchmark under which the effective annual cost of managing the assets should not exceed 0.1 per cent of the capital stock. This target is based on Sweden's experience with the publicly managed default fund, AP7, and on the economies of scale achievable in a large mandatory system. Competition among private funds seeking inclusion in the limited range of approved options should also help keep fees low. Investment performance and all fees must be communicated transparently, including during difficult market periods.

The political test

The proposal also poses challenges. Introducing the funded pension will increase contribution rates. For employees, the additional contribution constitutes individual retirement saving. Employers, however, could face an additional payroll cost of between 0.5 and 1 percentage point, depending on the extent and pace of implementation of measures such as the higher retirement age, the sustainability factor and the inclusion of the self-employed. This is a significant burden in Germany's difficult economic environment.

The greater and more immediate risk, however, is political. The funded pension is part of a carefully balanced package. If the governing parties weaken measures such as the higher retirement age or the sustainability factor, labour costs will rise without stabilising the pension system. Implementing the package will show whether they are willing to compromise and accept measures that do not fully reflect their individual political preferences. This is a crucial test of Germany’s capacity to implement difficult but necessary reforms.