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Comments on Dr. Martin Werding's paper: "Implicit Pension Debt and the Role of Public Pensions for Human Capital Accumulation: An Assessment for Germany"

by

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Dr.Werding's well-written paper consists of two parts. The first part takes up the lessons that we get from the preceding studies and demonstrates that there remains a huge amount of net pension liabilities (IPD) despite a series of reforms in Germany. The second part discusses a negative impact of unfunded pension schemes on human capital accumulation and provides a reform plan to mitigate it.

Regarding the first part, I believe that two definitions of implicit pension liabilities—that is, accrued-to-date liabilities (ADL) and open-system liabilities (OSL)—are very useful in understanding public pension problems in general.

The ADL is linked to the basic identity which we should bear in mind when addressing pension reform issues: that is, ADL - Social security fund = future contributions - future benefits. This identity makes it clear that any pension reform is irrelevant as far as ADL is fixed—in other words, any pension reform should incorporate a change (reduction) in ADL. In fact, figure 4 suggests that German pension reforms have kept reducing ADL.

The OSL discussions demonstrate that the OSL should be covered by "Open-system Asset" (OSA), to make the pension scheme *complete*: OLS (=ADL + future benefits) should be equal to OSA (=SS fund + future contributions). But Figure 7 implies that German authorities present an *incomplete* scheme, leaving OSL not covered by OSA. This raises a question: whether do German authorities implicitly or explicitly intend to raise taxes or reduce benefits further? In addition, the OSL reveal serious trade-off between present and future generations, suggesting that there is no Pareto-improving pension reform.

In the second part, he provides a simple but excellent model to explain fiscal externality of children and sub-optimal fertility. And his estimation of fiscal externality (Table 4) is quite impressive. His model justifies a need for further child allowance as the *second best* policy. However, he is skeptical of its effectiveness and calls

for changes within the pension system. It sounds realistic, but I think that we need some theoretical model to support this strategy.

More generally, I am skeptical of effectiveness of child allowance in raising fertility. As mentioned in the paper, many preceding studies confirm a negative correlation between PAYG pension benefits and fertility. But I think we need more analyses that confirm a positive correlation between child allowance and fertility, in order to justify child allowance.

Finally, he presents a quite interesting pension reform plan which differentiates benefit entitlements according to individual's efforts to bring up and educate children. It sounds quit reasonable and realistic. But I am curious about the impact on fertility and interested in how fertility is affected by policy changes in simulations.

All in all, this paper is very informative as well as helpful in understanding and addressing public pension issues from a balance sheet viewpoint.