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The child starter fund: a brilliant idea!

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Returns and financial literacy: Killing two birds with one stone

Recently, Germany's Council of Economic Experts, colloquially known as "the Five Wise Men," came up with a truly brilliant idea: the child starter fund. What’s the concept? The state would grant every child €10 per month upon reaching the age of six. But, of course, this isn’t for buying Minecraft cards or animated Barbie horses! No, the money would be invested long-term in a broadly diversified stock fund. This fund would be available to the young adults once they reach the age of majority.

Early childhood financial education

The Benefits are Clear

On October 30, the world will celebrate the 100th World Thrift Day, which aims to encourage also children and young people to save. Typically, their hard-earned savings end up in savings accounts, in Germany called “Sparbuch”, with near-zero interest rates.

Children, in this respect, are no different from their parents. Germans are world champions at saving, but they save the wrong way. They tend to invest in low-yield forms and remain skeptical about stocks. The fear of market losses overshadows the much more probable returns. As a result, wealth in Germany grows slowly despite high savings rates, and it is extremely unequally distributed: the bottom half of the population holds only 2% of the wealth.

Parents can learn something, too

With the child starter fund, not only will kids learn firsthand how to build wealth, but their parents will also gain valuable insights. This is financial education in its purest and most effective form. As Mephistopheles in Goethe's "Faust" put it: "All theory, dear friend, is gray, but the golden tree of life springs ever green."

The child starter fund is also superior to the currently in Germany discussed funded component for the pension system called "generational capital" because it allows citizens to gain direct and personal experience with the capital market from a young age. The capital market should not be the privilege of a few well-off individuals but should offer opportunities to all. Even if there are one or two bad years on the stock market (which can happen!), the long investment period will cushion this. The child starter fund helps to mitigate the striking inequality of wealth distribution and shows young people how effectively they can save for their own seemingly distant old age. Given Germany's demographic decline, complementary private savings alongside the public pension system are more important than ever.

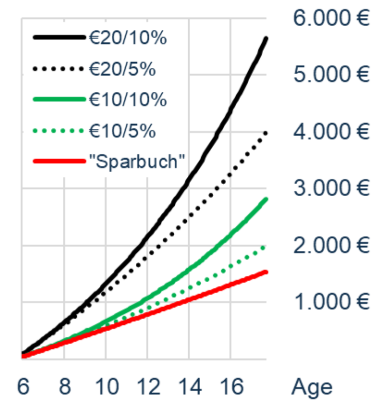
A bit more generous, please!

I hope that German politicians will implement the Wise Men's proposal and that they will be bolder than the experts. The suggested €10 per month seems too meager to achieve the desired effect. With €20 per month (less than a tenth of the monthly child benefit), significant sums could be accumulated by adulthood. With a conservative return of 5% per year, young adults could look forward to over €4,000 upon reaching adulthood. The historical average return for the MSCI World index is closer to 10%, which would amount to nearly €6,000 (see figure). That's enough to cover a couple of failed driving tests! If the money were put into a savings account instead, there would barely be enough for a decent bicycle.

With about 9.5 million children aged 6 to 18 in Germany, this would cost the state around €2.3 billion annually. Not a small amount, but significantly less than the €12 billion for the "generational capital" and, moreover, an excellently invested sum.

A contribution to a fairer distribution of wealth

Simulations for the child starter fund (various assumptions about the monthly amount and annual returns)



Source: LBBW Research. Assumption for savings account ("Sparbuch"): 1% interest per year