WSI
Institute of Economic and
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PENSIONS IN GERMANY – WHAT IMPACT DID THE PENSION REFORMS HAVE ON THE PENSION BENEFITS?

CCE-CNT information session Pensions
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Overview and introduction

- Germany's pension insurance was founded in the 1880s (workers' question, Bismarck)
- Aim of protection of living standard and dynamic benefits were introduced in the post-war era
- 2001 reform is often seen as a paradigm shift
  - Standard of living is not guaranteed by the public pension insurance alone anymore – new role for second pillar (occupational) and third pillar (private) pensions (→ new regulations and subsidies for funded pensions)
  - Background: worries about increasing contribution rates (→ non-wage labour costs)
  - Other reforms followed
- This presentation: information on the German pension system and the consequences of the 2001 reform

Pension system: general characteristics of the public pension insurance

- public **pay-as-you-go** system, includes incapacity to work and survivors pensions
- covers **employees** (not civil servants, only few self-employed professions)
- financed by **contributions** (employers and employees) and state **subsidies**
- **contribution rate 18.6 percent** of payrole
  (up to contribution ceiling at about twice the average income)
- **public pensions are meant to protect living stand *only in combination* with private or occupational schemes (2001 reform)**
- deduction-free **retirement age is raised to 67** in 2031 (63 with deduction)
- **benefits reflect** (complete) **individual life courses** (especially employment careers)

Calculation of individual pensions – entitlements and benefits

Gross pension:
Pensions are subject to taxes (phasing-in period) and contributions to health and long-term care insurance

PEP: Personal Earning Points. One point equals one year of contributions with general average gross wage (2022 about 40,500 Euro)

pension (Euro) = PEP * AR

2022 (west)
45*35.11 Euro = 1,580 Euro
AR until June 30th: 34.19 Euro, since July 1st: 36.02 Euro

AR: Current Pension Value (Aktueller Rentenwert). This value (in Euro) is adjusted annually according to a formula for both entitlements and benefits.→ next slide

Annual adjustment

$$AR_{(t)} = AR_{(t-1)} \times \underbrace{\frac{BE^{VGR\,t}_{(t-1)}}{BE^{VGR\,t}_{(t-2)} \times \left[\dfrac{\dfrac{BE^{VGR\,t-1}_{(t-2)}}{BE^{VGR\,t-1}_{(t-3)}}}{\dfrac{bBE^{DRV\,t}_{(t-2)}}{bBE^{DRV\,t-1}_{(t-3)}}}\right]}}_{\text{Entgeltfaktor}} \times \underbrace{\frac{100 - AVA_{(2012)} - RVB_{(t-1)}}{100 - AVA_{(2012)} - RVB_{(t-2)}}}_{\text{»Riester«-Faktor}} \times \underbrace{\left[\left[1 - \frac{RQ_{(t-1)}}{RQ_{(t-2)}}\right] \times \alpha + 1\right]}_{\text{Nachhaltigkeitsfaktor}}$$

»Riester«-Treppe

adjustment according to wage development

automatic adjustment mechanisms: they are to reduce pension increases below wage development to reduce the rise of contribution rates

Source of illustration: J. Steffen (2022), www.portal-sozialpolitik.de

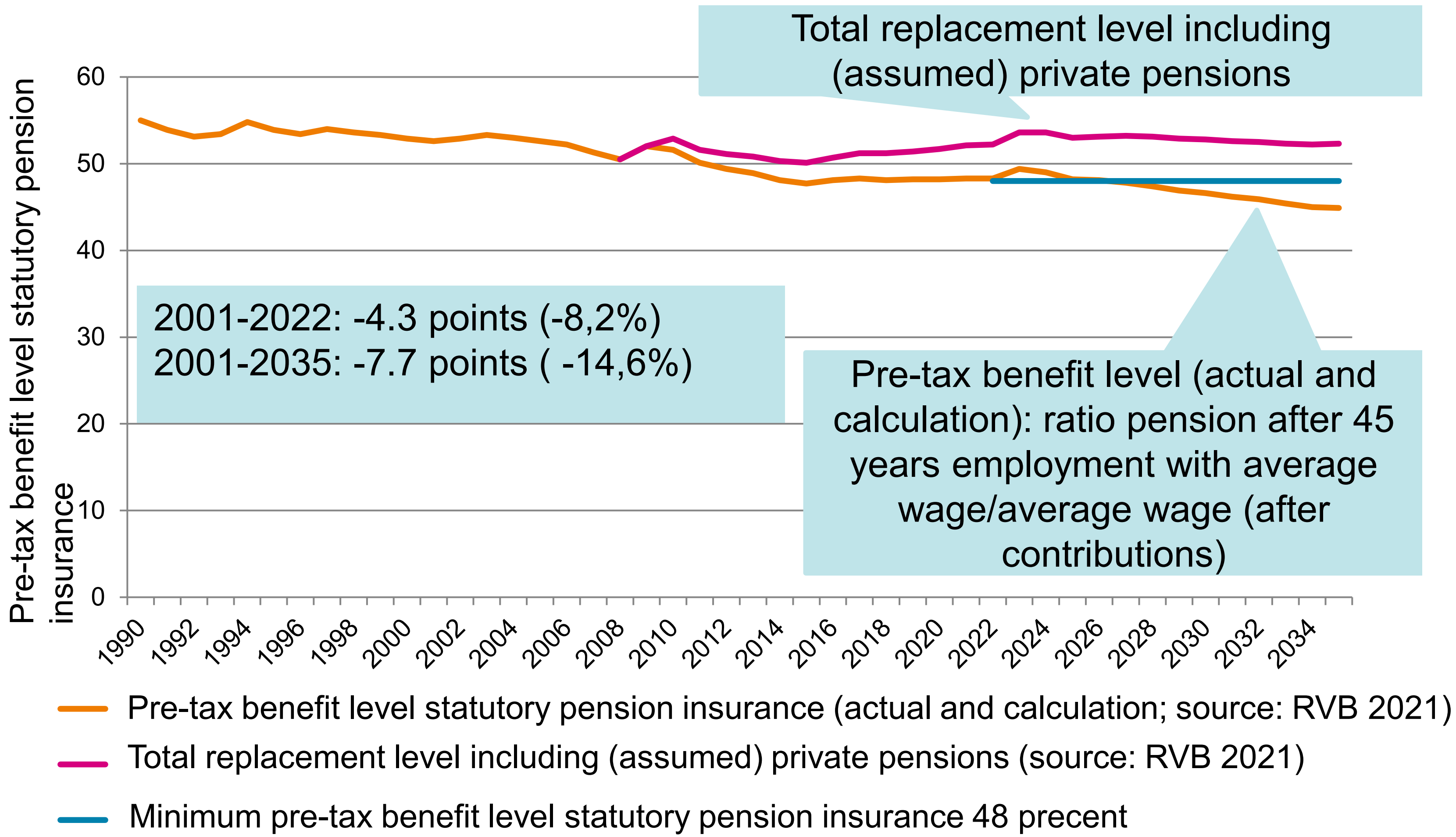
Annual adjustment explained

1. Adjustment mirrors the development of **gross wages** of insured employees (with two years delay).
2. The **wage-oriented adjustment is reduced**
   a. in eight steps, each about 0.6 percentage points (reflecting (fictional) savings for private pensions) (= past development)
   b. when contribution rates to the pension insurance rise → increasing contribution rates lead to a lower adjustment
3. A **sustainability factor** reflects the ratio of standardized pensioners to average contributors.

→points 2 and 3 are meant to **lower benefit levels** (i.e., weaken the link of pensions and wages); the mechanism “backfired” in some years due to the good labour market performance

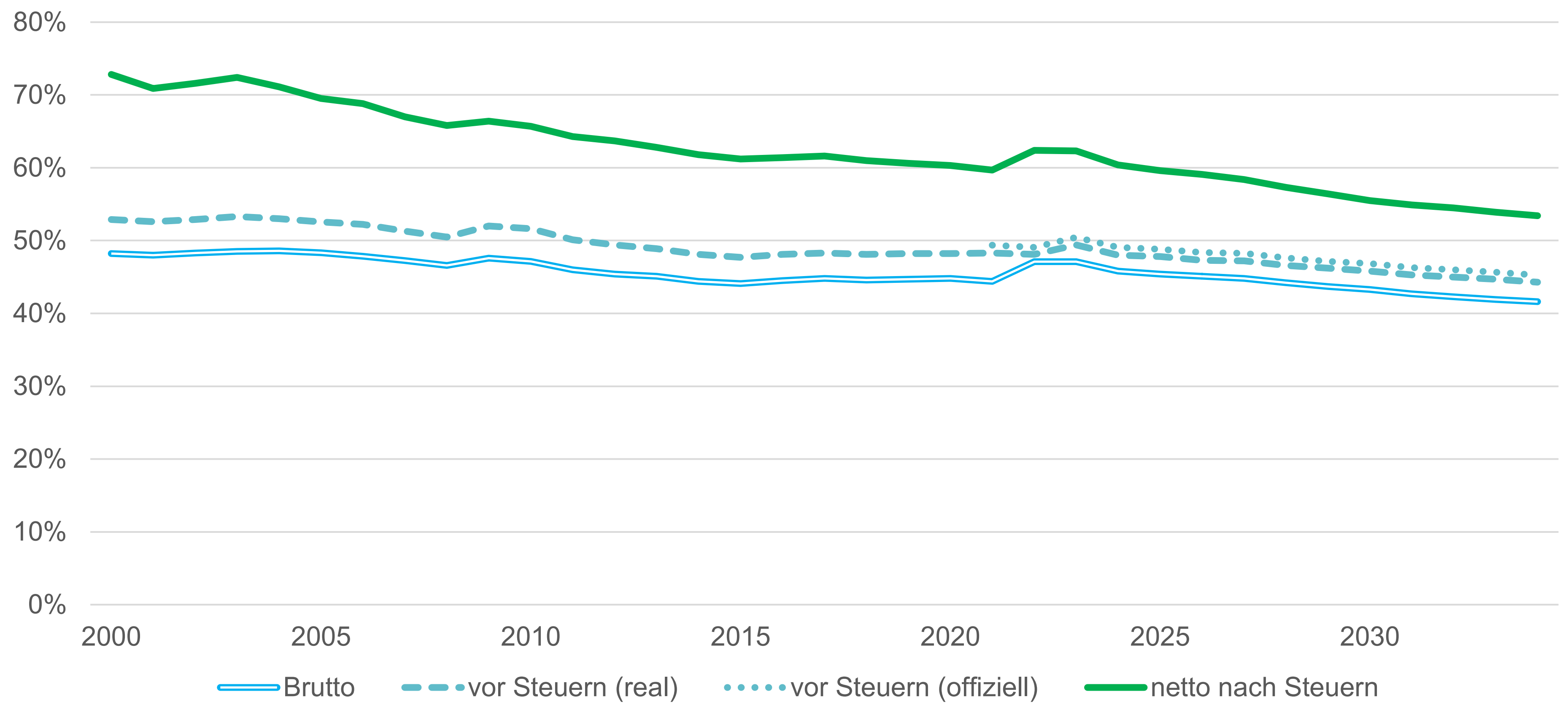
→**new backstop** if benefit level (after social insurance contributions) falls below 48 percent (currently 48.1 percent)

Development of pension level (Rentenniveau), official calculations



AR and pensions increase (and will increase), but slower than wages → lower benefit level

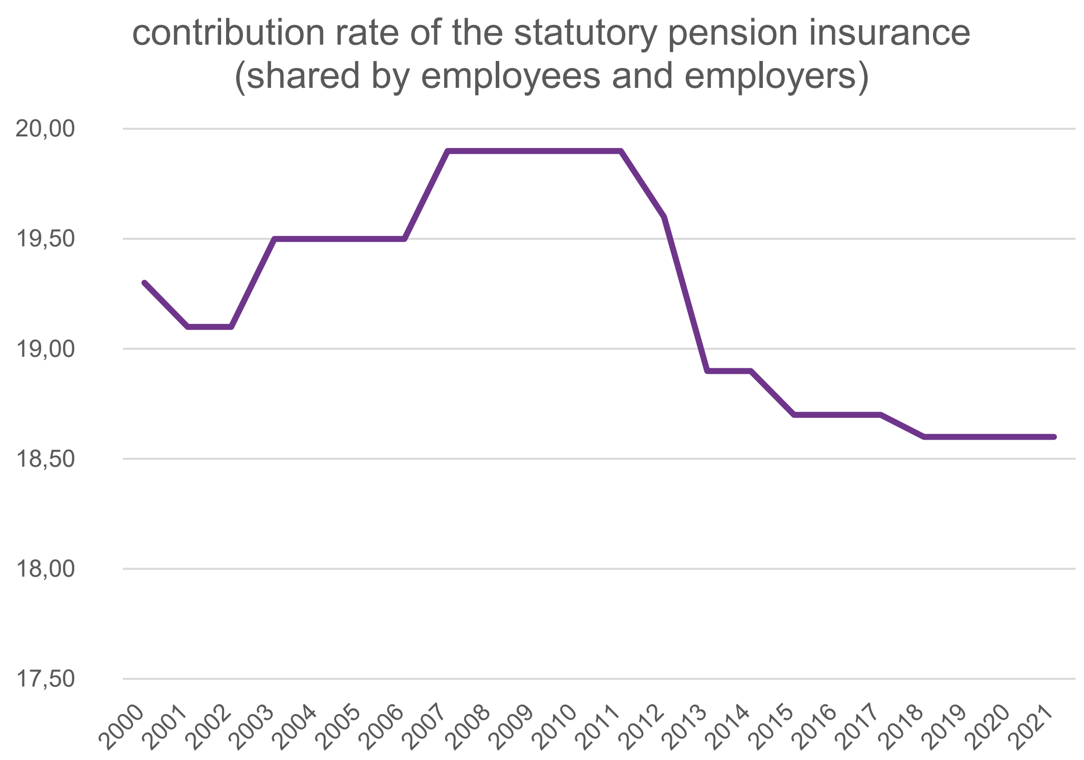
Development of pension level (Rentenniveau), additional calculations

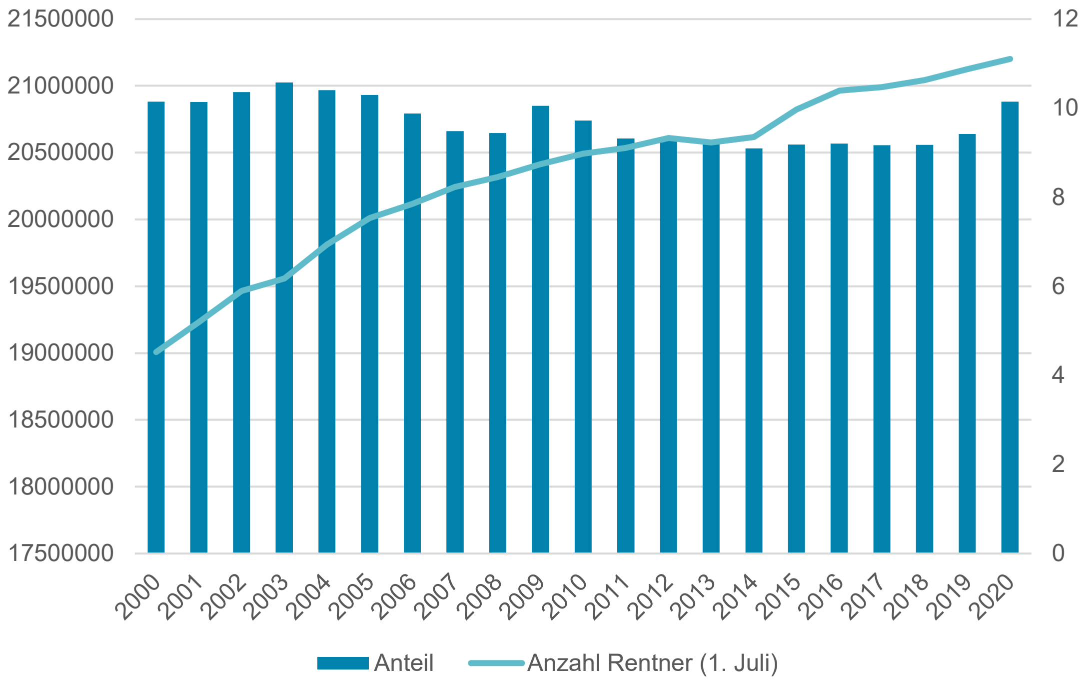


gross | net, pre-tax (real) | net, pre-tax (offical) | net, after taxes

Calculations by I. Schäfer, German Trade Union Confederation (DGB)

Contribution rates, benefit recipients, expenditures



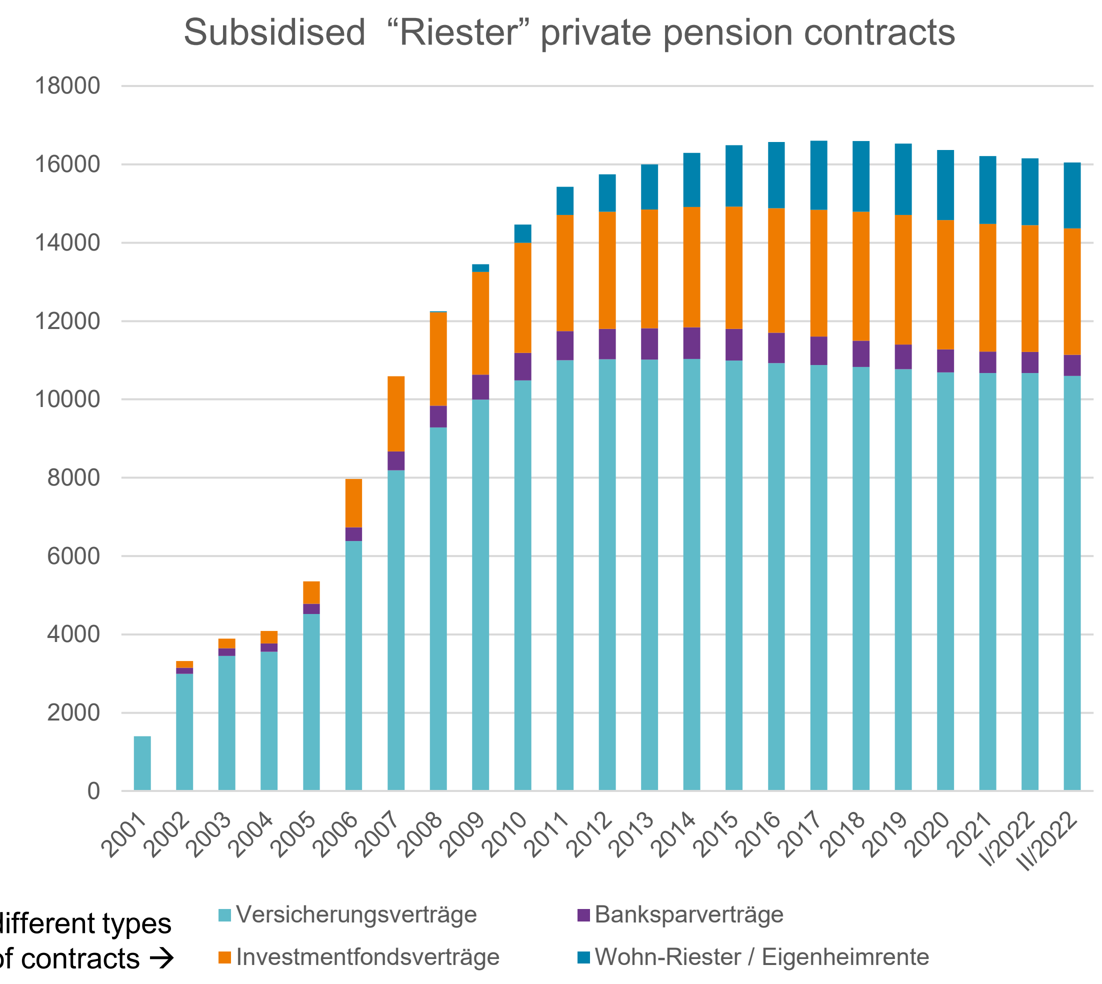


total expenditures of statutory pension insurance as share of GDP

number of pensioneers in the statutory pension insurance

Employees are expected to voluntarily save another 4 percent of their wages (including subsidies)!
→ total contributions: 22.6 percent!

Private pensions



different types of contracts →

Problems with the privatised pension system

- number of users and bias of use
- market structures and assumption of rational consumer
- unclear benefits (returns), high costs, lack of data for evaluation
- which risks are covered?
- (structure of subsidies (+))

Basic problem: costs shifted from employers to employees! → In addition to half of the contribution rate of 18.6 percent, employees are expected to save 4 percent of their wages!

General remarks

- The reforms of the early 2000s lead to a lower benefit level
  - Employees are expected to close the gap trough additional savings
  - The costs of an ageing society were privatised
- Current debates focus on the adjustment mechanism. Retirement age and funding are also topics of the debate. The point system is widely accepted.
  - Not only does the adjustment mechanism lead to lower benefits relative to wages, it is opaque
  - Current reforms seek to stabilize the benefit level but stick to the multi-pillar system
- Some general remarks for reform debates:
  - Is an adjustment mechanism needed? Are discretionary decisions possible? Is there a middle way (rules in combination with a parliamentary decision)?
    - A mechanism does not necessarily relieve politics
  - How does the pension system interact with the tax system?
  - Who pays?

THANK YOU FOR YOUR ATTENTION!

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