PENSION POLICY NOTES

GERMANY

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- **Raise pension prospects for people with low lifetime income**
- **Integrate all self-employed and the civil servants in the general public pension scheme**

Pensions are low for low earners. The public scheme for private-sector workers is a pay-as-you-go points system. It is mandatory for all employees but only for less than 10% of the self-employed. Another 25% of the self-employed mandatorily contributes to occupational pension schemes while for the remainder pensions are voluntary. Civil servants receive comparatively high pensions from a separate tax-financed defined benefit scheme. A full career at the average wage as a private-sector employee currently results in a gross replacement rate of 42%, compared to about 56% on average in the OECD. The gap to the OECD average is even larger for low earners as, unlike in most OECD countries, the German earnings-related pension system has no in-built redistribution feature across income levels. Social assistance benefits equal about 20% of the gross average wage. Although nearly half of all pensions lie below this means-tested benefit, only 3% of pensioners receive it due to other sources of income or wealth. About half of all current workers have a voluntary occupational pension plan, while about one-third have a voluntary Riester plan. An above-average gender pay gap and a large share of women working part-time result in the largest gender pension gap among OECD countries (46%). The statutory retirement age is currently 65 and 7 months, gradually rising to 67 by 2031. Retiring with penalties will remain possible with at least 35 years of contributions from age 63.

Key indicators: Germany and OECD average

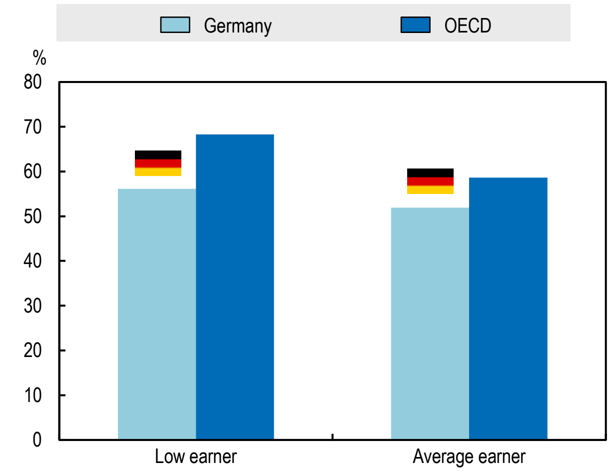
	Mid-1980s	Mid-1990s	Mid-2000s	Latest available	Latest OECD	Long term	Long term OECD
Normal retirement age for a full-time career starting at the age of 22	63 (60)	63 (60)	65 (62.1)	65.5	64.2 (63.5)	67.0	66.1 (65.7)
Statutory retirement age	63 (60)	63 (60)	65 (62.1)	65.5	64.5 (63.8)	67.0	66.5 (66)
Net replacement rate, average earner						51.9 (51.9)	58.6 (57.6)
Effective contribution rate (average earner)				18.6	18.4		
Total pension spending, % of GDP	11.0	10.9	11.8	10.9	10.0		
Public pension spending, % of GDP	10.5	10.3	11.1	10.1	8.4		
Public debt, % of GDP	..	54	72	70	80		
Employment rate 55-64, %	53.6 (21.3)	48.2 (26.8)	53.6 (37.6)	76.1 (66.9)	68.5 (54.8)		
Labour-market exit age	62.4 (60.2)	60.5 (59.2)	61.8 (60.7)	64.0 (63.6)	65.4 (63.7)		
Old-age poverty rate, %	9.2	9.7	8.5	9.6	13.5		
Life expectancy at 65, years	13.6 (17.3)	15.1 (18.9)	17.0 (20.4)	18.3 (21.3)	18.1 (21.3)	22.8 (25.1)	22.5 (25.2)
Old-age to working-age ratio	0.24	0.25	0.31	0.36	0.31	0.61	0.58
Fertility rate	1.4	1.3	1.4	1.6	1.7	1.7	1.7

Note. The figures for women appear in parenthesis where they differ from those for men. Long term: Around 2065 based on all legislated reforms up to mid-2019.

The German pension system is under pressure. The German society has been ageing rapidly due to persistently low fertility rates and longevity increases. The number of people older than 65 years per 100 people aged 20 to 64 is among the highest in the OECD. It increased from 24 in 1990 to 36 in 2020, and is projected to rise to 58 by 2050; this is substantially above the OECD average of 31 in 2020 and 53 in 2050. To limit the impact of ageing on public pension expenditures, a sustainability factor automatically lowers pensions if the ratio of contributors to pensioners declines. Voluntary Riester contracts, which were created to compensate for declining public pension benefits, are becoming less popular within the low interest-rate environment, especially as fees are high. Moreover, many low earners, part-time workers and those with incomplete careers cannot afford contributing significantly into a private pension, thereby reinforcing old-age poverty concerns.

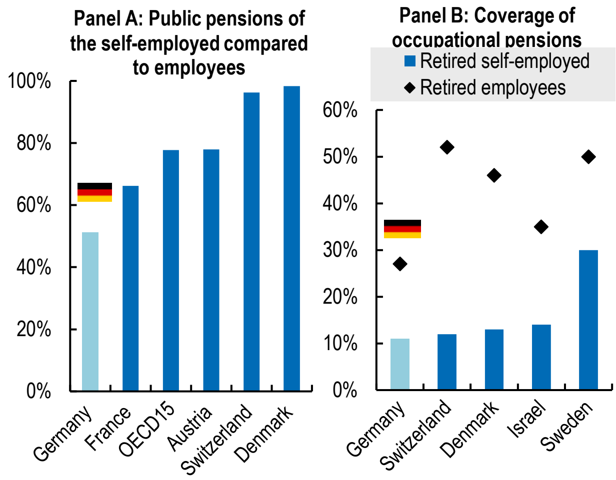
Future replacement rates might keep falling despite recent measures. A 2018 law puts until 2025 both a floor on the point value - such that a full career at the average wage yields a replacement rate after social security contributions and before taxes of at least 48% - and a ceiling of 20% on the contribution rate, while planning additional tax money to balance the pension budget. Yet, the strongest effects from ageing are projected to materialise after 2025. The planned increase in the statutory retirement age might not be sufficient to extend these guarantees without further tax injections. Effective retirement ages are increasing, however. Since 2000, the employment rate among the population aged 55 to 64 increased by almost 35 percentage points and is now above the OECD average. Yet, employment rates after age 64 remain low and the effective labour market exit age is below the OECD average. Combining work under reduced hours with partial pension receipt was introduced in 2017 to encourage working longer, but the total effect on labour supply might be negative due to fewer weekly hours worked. Moreover, since July 2014, workers with 45 years of contributions can retire from 63 (gradually rising to 65 by 2029) without penalties, making up more than one quarter of new applicants of old-age pensions since introduction. The defined benefit rules covering civil servants – in particular at the federal level - lead to one of the largest differences, within the OECD, in pension levels compared to private-sector workers with a similar wage profile. Such gaps generate inequalities and limit professional mobility, in addition to the administrative cost of maintaining different pension schemes.

Long-term net pension replacement rates in Germany are low



Source: OECD - Pensions at a Glance 2019 based on OECD pension models.

Low pensions and low coverage of the self-employed



Note: 2017 data. Division in self-employed and employees is based on where the bigger share of working life has been spent. Source: OECD Pensions at a Glance 2019, Fig. 2.6.

Further structural reforms are needed to improve the pension system and counteract ageing effects. Linking both early and standard retirement ages to gains in life expectancy would help balance the pension budget. Maintaining similar replacement rates would then require to work longer. Higher benefits might still be needed for groups with low lifetime income in order to alleviate old-age poverty concerns. An end-2019 coalition agreement plans to introduce from 2021 an income-tested minimum pension for people with about 35 years of work, maternity leave or long-term care tasks in the family. While this would improve the pension prospects of some low earners, additional measures might be needed to address old-age poverty risks of low earners with career breaks. Dropping the contribution-length requirement of the planned minimum pension - while prorating its benefit level based on the number of contribution years - or lifting the social assistance level might thus be necessary to overcome low pension prospects. The current coalition also agreed to expand mandatory pension coverage to all self-employed but a law has not been legislated yet. Increasing the pension coverage of all self-employed through the general public pension scheme would improve their often bleak pension prospects. As Germany is among only four OECD countries maintaining a totally separate scheme for civil servants, integrating this scheme with that covering private-sector workers would both reduce inequalities, increase labour mobility and may provide further leeway for pension finances.

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