Pensions at a Glance 2015

GERMANY

1 decembre 2015

Key findings

- **Germany is facing rapid population ageing. According to the projection of the Ageing Working Group of the European Union, Germany will spend** 12.5% of GDP on public pensions by 2050, against 10% on average in the OECD.

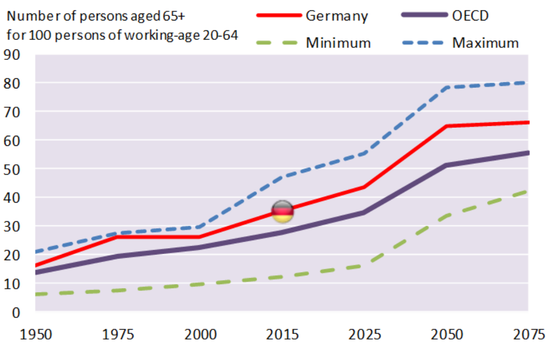
- **The value of the old age safety net is relatively low. Individuals who have never contributed to the pension system receive 19% of the average earnings against 22% on OECD average.** The poverty rate of people over 65 standsat 9.4% and is below the OECD average of 12.6% but much higher than in other European countries including Denmark, France and the Netherlands.

- **Net pension replacement rates for future retirees are below the OECD average, especially for low-wage earners.** German workers earning half the average wage and retiring after a full career may expect a net replacement rate of 53% in the long term against 75% on average across the OECD. For average-wage workers, replacement rates will also be below average, at 50% compared to 63% in the OECD.

- **Working longer may help to improve both financial sustainability of the pension system and retirement-income adequacy.** Employment rates of people aged between 55 and 64 have improved in most OECD countries over the last decade. The greatest increase occurred in Germany from a relatively low level of 42% in 2004 to 66% in 2014. In contrast to the main trends elsewhere, the pension age was temporarily lowered in 2014 from 65 years to 63 for individuals with 45 years of contributions.

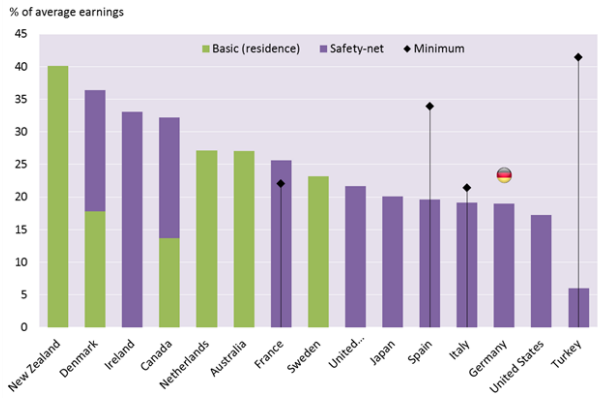
  Retirement-income adequacy may be an important concern for vulnerable groups and in particular for women who today represent two-thirds of Germany's current pensioners. Germany is one of four countries which gives the same credits to mothers who continue to work and those who interrupt their careers for childcare reasons. As a consequence, women on average earnings who interrupt their careers for five years to care for two children lose the most pension entitlements compared to other OECD countries, but these rules provide strong incentives for mothers to remain in the labour market.

Figure 1: Demographic dependency ratio



[PAG2015 Table 7.5]

Figure 2: Value of first–tier pensions



[PAG2015 Figure 2.6]

Why is it important for Germany?

Over the past ten years, employment rates of German workers aged 55 to 64 years have risen from 45 to 66%. In addition, the retirement age is gradually increasing by one month a year from the current level of 65 years and four months to reach 67 for individuals with less than 45 years of contributions.

In contrast, full pension benefits (without penalties) will be awarded below the legal retirement age to people who started their career early in both France and Germany, though in Germany this is only a temporary measures. This increases pension entitlements, but sets a signal by encouraging eligible workers to exit the labour market early. In Germany, the pension age was lowered from 65 to 63 for individuals with 45 years of contributions but will increase again by two months each year from 2015 back to age 65.

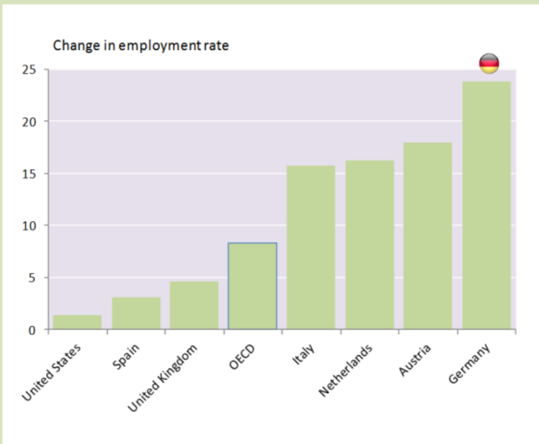
The employment of older workers has increased impressively in recent years. Yet, in 2014 the average effective age of labour market exit was 62.7 years for both men and women, and thus below both the normal pension age and below the OECD average of 64.6 years for men and 63.1 for women in 2014.

Many individuals spend time out of paid employment for various reasons, such as childcare, and early labour market exit is still common. While credit mechanisms in the German pension system effectively cushion the effect of short career breaks (up to 3 years), the pension losses become large as the break lengthens. Germany is one of the countries where an average-wage mother who interrupts her career for five years to care for two children loses the most in terms of pension rights. This is because in Germany the child-related pension credit applies whether the mother interrupts her career for childcare or not. In 2014 the Government introduced pension of credits for children born before 1992, which retroactively increase pension benefits. In addition, the share of part-time work among women is 37% compared to the OECD average of 22%. Striking the right balance between length of leave from work and benefit entitlement is fundamental to ensure that people return to work but do not lose too much from work interruptions.

Older people have on average incomes above 87% of the national average. Poverty rates (at half the median equivalised household income) are slightly higher for people aged 65 and above (9.4%) than for the whole population (8.4%). They are, however, much lower than those observed among the youth aged between 18 and 25 years. Gender differences in the old-age poverty rates are also large important as 12.3% of women aged 65 and over are income poor compared to 6.3% among men of the same age.

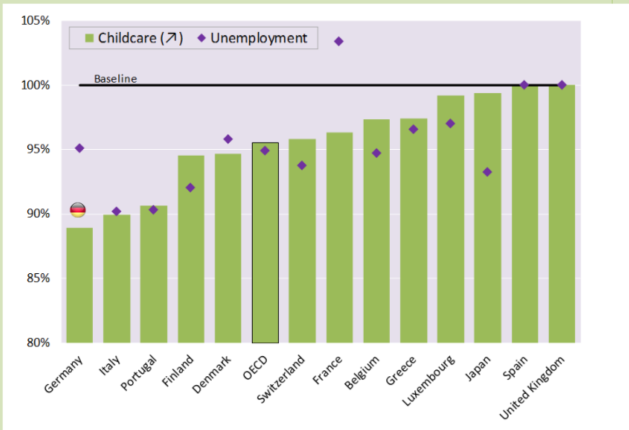
At 19% of average earnings, safety-net benefits are low compared to 22% in the OECD on average. There is considerable variation across OECD countries for people not eligible to contributory benefits. Old-ae safety nets are as high as 40% of average earnings in New Zealand and 36% in Denmark, but only 6% in Korea and Turkey, with Germany falling in the bottom third of countries.

Figure 3: Changes in employment rate of older workers (55-64), 2004-2014



[PAG2015 Figure 7.6]

Figure 4: Change in replacement rate with five year career break



[PAG2015 Figure 3.13]

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2015 Pension Policy Notes

GERMANY

- **Increase the normal retirement age faster and link it to gains in life expectancy.**
- **Enhance employment-friendly family policies such as the availability to full time childcare.**

The German pension system is under pressure due to unfavourable demographics. The statutory public scheme is an earnings-related points system financed on a pay-as-you-go basis. The calculation of the pension benefit is based on the number of pension points earned throughout the working career. Additional means-tested benefits can be claimed from the social assistance. Voluntary occupational pensions (*Betriebliche Altersvorsorge*) can be granted by employers, and about half of all workers belong to these schemes. The overall system has basically no redistribution feature, but the old-age (relative) poverty rate is below the OECD average. The pension age is currently 65 and 4 months (gradually rising to 67 by 2029) with at least five years of contributions. As of July 2014 special length of service pension is paid at age 63 for workers with 45 years of contributions. From 2016 this age will increase until it reaches 65 in 2028.

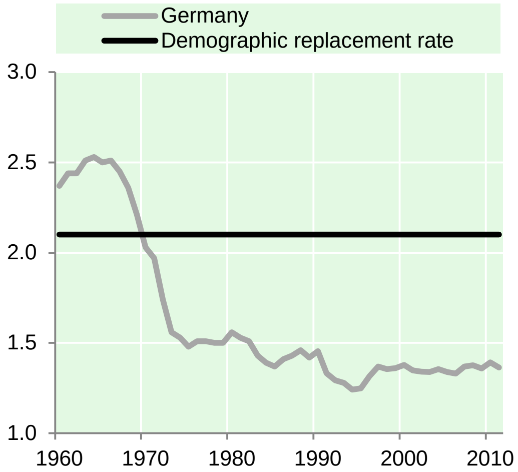
Key indicators: Germany and OECD average

	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	63.0 (60.0)	65.0	65.0	65.0		65.0	
Retirement age	65.0 (60.0)	65.0	65.0	65.2	62.9 (61.8)	67.0	64.6 (64.4)
Net replacement rate, avg earner						50.0	63.0 (62.6)
Total mandatory contribution rate		19.2	19.5	18.9	19.1		
Total pension spending, % of GDP	11.0	11.2	12.2	11.4	10.3		
Public pension spending, % of GDP	10.5	10.6	11.4	10.6	8.4		
Public debt, % of GDP	..	54	70	79	115		
employment rate 55-64, %	53.6 (21.3)	48.2 (26.8)	53.6 (37.6)	71.4 (60.0)	66.1 (49.1)		
Labour-market exit age			61.8 (60.7)	62.7 (62.7)	64.6 (63.1)		
Old-age poverty rate, %	9.2	9.7	8.5	9.4	12.6		
Life expectancy at 65, years	13.6 (17.3)	15.0 (18.8)	17.0 (20.4)	18.3 (21.4)	18.4 (21.5)	23.2 (25.9)	22.9 (25.9)
Old-age dependency ratio	0.24	0.24	0.31	0.35	0.28	0.67	0.57
Fertility rate	1.4	1.3	1.4	1.4	1.7	1.7	1.8

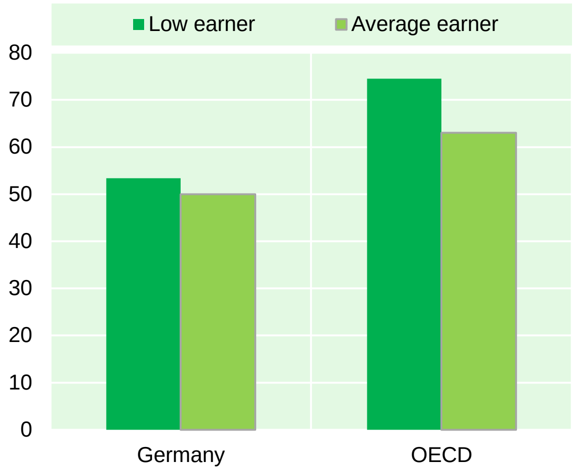
Note. The figures for women appear in parenthesis where they differ from those for men.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

Pension contributions rates will increase based on current legislation and benefits will become less generous due to the dismal demographic outlook. The German society has been ageing rapidly due to persistently low fertility rates and increases in longevity. The average fertility rate has been below the demographic replacement level for almost 45 years, and by 2050 France and the United Kingdom would surpass Germany in population size. The old-age dependency ratio (the ratio of people aged 65 and above divided by the number of people aged 20 to 64) is the third highest in the OECD. It has increased from 0.24 in 1970 to 0.35 in 2015, and is projected to double by 2060 at 0.68; this is far above the OECD average of 0.26 today and 0.52 in 2060. Furthermore, future net replacement rates for full-career average-wage workers are projected to be well below the OECD average (57% compared to 66%), while the pension contribution rates are planned to increase to 22%, which is also comparably high. The combination of rapid ageing, low future benefits and high pension contribution rates will make any needed additional adjustments in the form of benefit cuts or increases in contributions difficult. Consequently, new changes might have to come through higher retirement ages. To some degree this is already happening. In the last 10 years, the employment rate of people aged 55 to 64 has increased by almost 25 percentage points and is now above the OECD average. Yet, this is still below the best preforming countries and the labour market exit age is below the OECD average. A high incidence of low-pay and part-time work also raises concerns about future old-age poverty risks.

Total fertility rate 1960-2011



Long-term net pension replacement rates



Sources: OECD Society at a Glance 2014, OECD pension models.

Beyond their cost recent measures might have a negative influence on social norms. In July 2014, the pension age was reduced to 63 years for people with 45 years of contributions from 65 years. In addition, child credits were retroactively allotted to women with children born before 1991.

Further structural reforms such as increasing the normal retirement age faster and linking it to gains in life expectancy are needed to counteract the negative effects of demographic ageing on pension system delivery. Political pressures to spend more on current retirees or on those close to retirement are likely to increase as the population and the electorate become older. Working more and longer and increasing employment rates for all age groups will be important to increase the prospects that pensions system could deliver on promises. In addition, expanding output and thus revenues will enable the economy to finance public services, notably health and long-term care services, which would contribute to the wellbeing of the elderly. Demand for these services will grow as the share of the very elderly increases in the population. Employment-friendly family policies (such as the availability of fulltime child care and income-related family benefits) that enable young men and women to combine work and family life are also important to change the overall demographic structure in the long-term and to increase employment rates. However, even if fertility rates return to the demographic replacement level (about 2.1) the demographic outlook will remain bleak for a long period.

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