Company pension schemes in Germany

In Germany there is a long tradition of company pension schemes being provided by the employer. These schemes constitute the "second pillar" of retirement provision, between state and private pension provision. Statutory pensions will continue to be the most important source of retirement income, even taking account of the recent changes in pension regulations. However, in view of the benefit reduction intended to stabilise the contribution rate, supplementary measures are necessary if the current level of retirement provision is to be maintained. These can be taken within the framework of private saving or through collective pension agreements, such as company pension schemes. In this respect, the government's intention is to encourage a wide range of supplementary private and company-related pension provision by introducing tax incentives or giving direct grants. The importance of company pension schemes (according to the incomplete data available) has tended to stagnate over the past ten years, but these plans could make them more attractive in future. This article looks at the position of such schemes in the context of pension provision as a whole and at the outlook for the future – especially as affected by the new legislation.

Company pension schemes in the overall system of retirement provision

The three pillars of retirement provision

In industrial countries the overall system of retirement provision rests typically on three pillars. The main pillar is a state system, the aim of which is simply to provide a basic pension or to ensure that a certain standard of living is maintained. To differing degrees from one country to another, interpersonal redistribution effects also have a bearing on state pension provision. State systems are generally financed on a pay-as-you-go basis through taxes or compulsory contributions. In Germany both statutory pension insurance and social assistance must be seen as part of this basic system. The second pillar acts as a more far-reaching standard of living safeguard with no additional redistribution tasks. As a rule, this pillar is formed by company-based collective security systems, which can be either compulsory or voluntary.[1] The third pillar is that of voluntary private retirement provision, which is intended to satisfy special pension preferences. The second and third pillars are mainly funded.

The second and third pillars are becoming more important

The recent reform of statutory pension provision in Germany reduces the level of its future benefits, with the result that it is less able than previously to fully safeguard people's standard of living. The government has taken this as a springboard for necessary action. In order to close the foreseeable "provision gaps", both supplementary company and private pension provision is to be encouraged by tax concessions or direct grants. It will not, however, be compulsory to take out supplementary pension provision.

Structure of company pension schemes in Germany

Types of company pension scheme

The Act to Improve Company Pension Schemes, otherwise known as the Occupational Pensions Act *(Betriebsrentengesetz),* was passed in 1974 with the aim of regulating company pension provision. It contains provisions for all types of pension scheme, whether they are organised in-house (company-based pension schemes or benefit funds) or externally (direct insurance, staff pension insurance *(Pensionskassen)* or, in future, pension funds). (For details see the overview on page 45.) The provisions of the Act mainly relate to financing, non-forfeitability periods, liability, the type of commitment and the adjustment of benefits.

Financing

Until 1998 the employer had sole responsibility for financing company-based pension schemes, social benefits which may be voluntary or contractual. The 1999 Pension Reform Act *(Rentenreformgesetz)* made legal provision for employees to have contributions deducted from their gross pay and paid into a pension scheme. Employees may allocate portions of their current or future compensation to building up a company pension entitlement. The Bill promoting private pension plans *(Altersvermögensgesetz)* currently in the Mediation Committee between the Bundestag and Bundesrat (lower and upper houses in the German Parliament) provides, as a further development, for employees to be entitled to make such allocations from

1 In Germany civil service pensions, which may be considered to be a combination of the first and second pillars, occupy a special position.

Types of company pension scheme in Germany

Company-based pension schemes with provisions for pensions *(Direktzusage)*
In the case of company-based schemes, the employer enters into a contractual commitment to pay the employee a pension. The scheme is financed by the employer or through deductions from the employee's gross pay. The employer must build up pension provisions based on actuarial calculations to cover the pension commitment. These provisions are recognised for tax purposes. There is an outflow of liquidity in the disbursement phase only. There are no rules governing investment or statutory supervision. As there are no restrictions imposed on investment decisions, it is also possible for resources to be invested in an external investment fund. In the event of insolvency, benefits are safeguarded by the Pension Guarantee Fund *(Pensionssicherungsverein auf Gegenseitigkeit, PSV)*. In the pension build-up phase no wage tax is levied and the company pension is liable to tax.

Benefit funds *(Unterstützungskassen)*
Benefit funds are legally autonomous pension funds. They can be operated by one or more enterprises, which must allocate resources to them to ensure that they are able to pay. The enterprise itself may decide on the level of contributions and the time frame in which they are made. Employees have no legal entitlement to benefits from the benefit funds. However, they may generally claim against the enterprise. Should the company become insolvent, the promised benefits are safeguarded by the Pension Guarantee Fund (PSV). Benefit funds are not subject to supervision and are not required to comply with any investment criteria.

As social welfare institutions, benefit funds are exempt from corporation tax and trade tax. Resources allocated by the enterprise concerned are not subject to wage tax, while the subsequent pension is. Allocations made by the enterprise operating the fund before the pension becomes payable are only recognised for tax purposes until financial assets have been built up which, in addition to the capital cover for current benefits, are at least equivalent to two average annual pension disbursements for each person entitled to a pension from the fund (deduction constraints pursuant to section 4d of the Income Tax Act). As a rule, this does not achieve full funding of subsequent benefits. By contrast, **"reinsured" benefit funds** take out life insurance policies for those eligible for a pension. The premiums can be assumed by the enterprises operating the fund, thus virtually eliminating deduction constraints.

Direct insurance *(Direktversicherung)*
In this type of pension scheme the company, as the insurance policy holder, takes out an individual or group life insurance policy in favour of its employees. Life insurance companies are subject to government insurance supervision. The benefit risk is assumed by the insurance company. Contributions are basically subject to wage tax. Pursuant to section 40b of the Income Tax Act, a flat tax rate of 20 % (plus solidarity surcharge and, as appropriate, church tax) may be applied up to a ceiling of DM 3,408 a year. Up to this ceiling contributions are also exempt from social security contributions. If contributions are transferred directly from the employee's wages, exemption from social security contributions will continue to apply until the end of 2008 only. Disbursements are tax free; if they take the form of an annuity, they are subject to taxation of the earnings portion.

Staff pension insurance *(Pensionskassen)*
Staff pension insurance *(Pensionskassen)* comprises legally autonomous pension funds, which may be operated by one or more enterprises. These pay contributions to the staff pension insurance, which funds the pension benefits later paid to the employees. Staff pension insurance schemes guarantee legal entitlement to their benefits and are monitored by the Insurance Supervisory Office; for capitalisation and investment purposes they are subject to the provisions of the Act on the Supervision of Insurance Enterprises *(Versicherungsaufsichtsgesetz).*

As social welfare institutions, staff pension insurance schemes are basically exempt from corporation tax and trade tax. Contributions by the employer to the scheme are basically considered to be part of the employee's compensation package and therefore subject to wage tax. As in the case of direct insurance, it is possible, pursuant to section 40b of the Income Tax Act, to pay tax at a flat rate and to claim exemption from social security contributions (only until the end of 2008 if contributions are deducted directly from the employee's wages). Repayments are also tax-exempt or can take the form of an annuity, with only the earnings portion being liable for tax.

Furthermore, pursuant to section 3 number 63 of the Income Tax Act, tax exemption of contributions may be claimed up to 4 % of the income threshold for assessing contributions to the statutory pension scheme. In this case, too, expenditure is not subject to social security contributions; however, if contributions are deducted directly from the employee's wages, this applies only until 2008. Old-age pension benefits are then fully liable to income tax as other income within the meaning of section 22 number 5 of the Income Tax Act.

Pension funds *(Pensionsfonds)*
The Bill promoting private pension plans *(Altersvermögensgesetz)* provides for pension funds as an additional type of pension provision in section 112 of the Act on the Supervision of Insurance Enterprises. Pursuant to this Act, pension funds are legally autonomous institutions which operate a funded company pension scheme on behalf of the employer in return for the payment of contributions.

In the same way as staff pension insurance and direct insurance, pension funds guarantee entitlement and are subject to regulation by the Insurance Supervisory Office. The difference is to lie in greater flexibility with regard to capital investment. More precise details are, however, subject to authorisation being given by the government or the Federal Ministry of Finance. Pension funds are intended to be an instrument which complies with the proposal presented by the European Commission for a pension fund directive (COM (2000) 507 final, 2000/0260 (COD)).

The tax advantage is derived from the possibility, pursuant to section 3 number 63 of the Income Tax Act, of exempting up to 4 % of the income threshold for assessing contributions from tax and social security contributions (if contributions are deducted directly from the employee's wages, exemption from social security contributions applies only until 2008). Subsequent pension disbursements will then be fully liable to tax.

Promotion of supplementary pension provision pursuant to section 10a of the Income Tax Act
If contributions to direct insurance, a staff pension insurance scheme or a pension fund are made from employees' private taxable and "contributed" compensation, they can also claim the special tax allowance or the premium bonus pursuant to section 10a of the Income Tax Act. The maximum concessions are staggered. In 2002 the special tax allowance begins at 1 % of the income threshold for assessing contributions to the statutory pension scheme and only reaches the 4 % maximum in 2008. Subsequent pension disbursements are then fully liable to tax.

Deutsche Bundesbank

their compensation. Irrespective of the source of the payment, in economics terms both the employer and the employee see company pension commitments quite simply as part of the compensation package.

Non-forfeitability

Up to the present time, employees who transferred to another company did not forfeit their pension entitlement if they were at least 35 years of age and the pension commitment had existed for at least ten years. If the person concerned had already worked for the company for twelve years, a commitment of at least three years was sufficient. The pension reform aims at reducing these periods. Eligibility is to be non-forfeitable from the age of 30 if the commitment has lasted for at least five years.

Insolvency protection

Direct insurance schemes, staff pension insurance *(Pensionskassen)* and, in future, pension funds are monitored by the Insurance Supervisory Office and, in particular, must comply with the special investment regulations. However, there is no such protection of pension claims for company-based pension schemes and benefit funds. In 1975, therefore, the Pension Guarantee Fund was established to provide compulsory reinsurance for companies which have opted for these types of company pension scheme. The Pension Guarantee Fund guarantees company pension entitlement if the enterprise operating the scheme becomes insolvent. Member firms finance the Fund on a pay-as-you-go basis (see the table on page 47).

Types of benefit commitment

Company pension entitlement can be designed as a commitment to provide a defined benefit or simply as an obligation to make regular contributions. In the defined-benefit pensions that have so far been predominant in Germany, contributions are fixed or graded according to length of service or based on a portion of the beneficiary's compensation. Both types vary in terms of the risk inherent in the calculations for the employer, which is lower if the commitment is a fixed sum. By contrast, employers are likely to find pay-related commitments more advantageous as they increase employee incentive. A further type of defined benefit is an overall pension commitment, in which the level of benefit includes the statutory pension. However, the employer runs a considerable risk in this case because every reduction in statutory pension benefits must be offset by increasing the company pension. The most important example of this kind of commitment is the supplementary pension scheme in the German public sector.

Adjustment regulations

The Occupational Pensions Act also contains minimum regulations for the adjustment of current pension benefits. The adjustment rules were previously vague and were broadly interpreted in case law in favour of the person entitled to the benefit; the wording of the 1999 Pension Reform Act is more precise. It states that company pensions must be increased once every three years by at least the inflation rate[2] or by the growth in net wages in comparable groups of employees within the company concerned. An adjustment can

2 In section 16 (2) 1 of the Occupational Pensions Act reference is made to the consumer price index for four-member households of wage and salary earners with an average income.

The Pension Guarantee Fund – key data

Year	Member firms	Contribution rate 1	Cases of availment	Volume of claims	Newly registered employees 2
	Number at the end of the year	‰	Number	DM million	Number
1975	31,045	1.5	249	75	12,350
1980	32,547	1.4	161	171	13,864
1985	34,662	1.4	366	380	17,207
1990	36,712	0.3	158	333	13,564
1991	37,282	0.9	162	394	12,520
1992	37,758	0.8	207	424	21,679
1993	38,115	3.1	328	1,377	62,179
1994	38,179	2.3	348	832	39,920
1995	38,573	2.6	386	957	34,867
1996	39,045	2.8	404	1,417	71,622
1997	39,233	2.7	406	827	27,825
1998	39,737	1.2	379	758	27,152
1999	39,774	2.8	347	1,194	45,575

Source: Pension Guarantee Fund *(Pensionssicherungsverein),* Report for 1999. — **1** The income threshold for assessing contributions is the amount of the provisions or the capital cover of the benefit fund plus a blanket estimate of pension entitlements calculated at 20 times the employer's eligible annual allocations for income tax purposes (section 10 number 3 of the Occupational Pensions Act *(Betriebsrentengesetz)*. — **2** Newly registered pension recipients and employees with vested pension rights, whose company pensions must be paid in full or in part by the Pension Guarantee Fund.

Deutsche Bundesbank

generally be deferred if the company's financial situation so requires. The obligation derived from case law to make catch-up adjustments has been rescinded. Instead of this ruling, since 1999 it has been permissible for the employer to make an advance commitment to increase the subsequent pension by 1 % a year.[3]

Economic motives behind company pension provision

Significance for corporate financing

As employer-financed company pension provision continues to be a voluntary or contractual benefit, what economic considerations lie behind the decision to set up a company pension scheme? For the employer it is particularly important for a company pension commitment to represent business expenditure which is, as such, tax deductible, with disbursement only taking place later. In the case of company-based schemes which rely on provisions for pensions, the provisions may now be used for corporate financing purposes. In economic terms, they represent long-term lending resulting from the contributions to the pension scheme that are deducted from employees' wages; for tax purposes, an interest rate of 6 % is imputed, this being based on the assumed rate of interest applicable to the building-up of pension pro-

3 In the case of staff pension insurance schemes or direct insurance, it is sufficient for the enterprise to use all profit shares to increase the pension.

Taxation of inflows or outflows

From the point of view of the taxpayer, the advantages of taxing outflows can be demonstrated as follows. A capital contribution C achieves a yield at interest rate r, with tax rate t_e during the employment phase and t_a during retirement. If outflows are taxed, the capital stock including the accumulated interest income is taxed in the disbursement phase. Net disbursements P_o are thus

$$P_o = C(1+r)(1–t_a).$$

If inflows are taxed, the capital contribution is smaller, as it has to be raised from the taxed income. The interest income is also subject to personal income tax in the disbursement phase. The repayment of the capital stock built up from taxed income is, by contrast, tax exempt, resulting in the following overall lower net disbursement P_i:

$$P_i = C(1–t_e)[1+r(1–t_a)] = C[1+r(1–t_a)](1–t_e)$$

Taxation of outflows has an additional advantage if the tax scale is progressive and tax rate t_a is lower in retirement than tax rate t_e during the employment phase.

Deutsche Bundesbank

visions.[4] Transfers to company-owned benefit funds are also available as a safe source of internal financing.

Company loyalty

Company pension commitments are likely to cut staff turnover costs and to encourage staff loyalty, which is particularly important with regard to more highly qualified employees. If the non-forfeitability periods are long and the pension entitlement is designed to increase progressively in line with length of service, company pension schemes can become something of a "gilded cage".[5] This would seem to be somewhat at odds with macroeconomic mobility requirements.

Government support for contribution payments

Advantages in terms of tax and social security contributions also make company pension schemes attractive. These advantages vary according to the type of pension scheme and further variants are included in the Bill promoting private pension plans. Uppermost is the tax exemption of contributions, followed, however, by taxation of company pensions. Overall, this principle of taxing outflows has advantages for the taxpayer (see the adjacent overview). The exemption of social security contributions is also a significant factor, especially if the benefit entitlement which is thus acquired is not dependent on the level of contributions paid, as is the case for nursing insurance and, to a large extent, for health insurance, too. Neither is there a 100 % guarantee in unemployment insurance and pension insurance schemes that contributions will be matched. If and to the extent to which social security contributions can be considered to be taxes (because there is no prospect of corresponding return payments) exempting income from social security contributions can be seen as an economic bonus.

Cost advantages over private pension plans

In addition, there may be cost advantages compared with private pension provision. Owing to lower commission and administrative costs, collective agreements normally imply a reduction in costs, but they do restrict the individual's freedom to select investment opportunities according to his/her own preferences. The real decisive factor is not the

4 The financial advantage is derived from a comparison with the relevant alternative interest rate, which fluctuates considerably over time and has decreased markedly since 1982, when the assumed rate of interest was raised to its present level.
5 See Schnabel, Claus and Joachim Wagner, *Betriebliche Altersversorgung: Verbreitung, Bestimmungsgründe und Auswirkungen auf die Personalfluktuation, Arbeitsbericht No. 209,* University of Lüneburg, Faculty of Economics and Social Sciences, February 1999.

costs but the expected total yield of the pension scheme.

Development and spread

Incomplete data ...

Data on company pension provision in Germany are incomplete. Nor are they collected on a regular, comprehensive basis.[6] Sampling, surveys and estimations of partial aspects merely serve to paint a broad picture of the spread and significance of company pension schemes. This is all the more regrettable as company pension provision is a vital key in terms of economic and socio-political issues.

... make it difficult to answer important questions

This includes the bearing of company pensions on income during retirement, expenditure as a share of labour costs and the role of company pension schemes in corporate financing and macroeconomic capital formation. In addition, it should be noted that the preferential treatment of company pension schemes in terms of tax and social security contributions places a burden on public sector budgets.

Spread

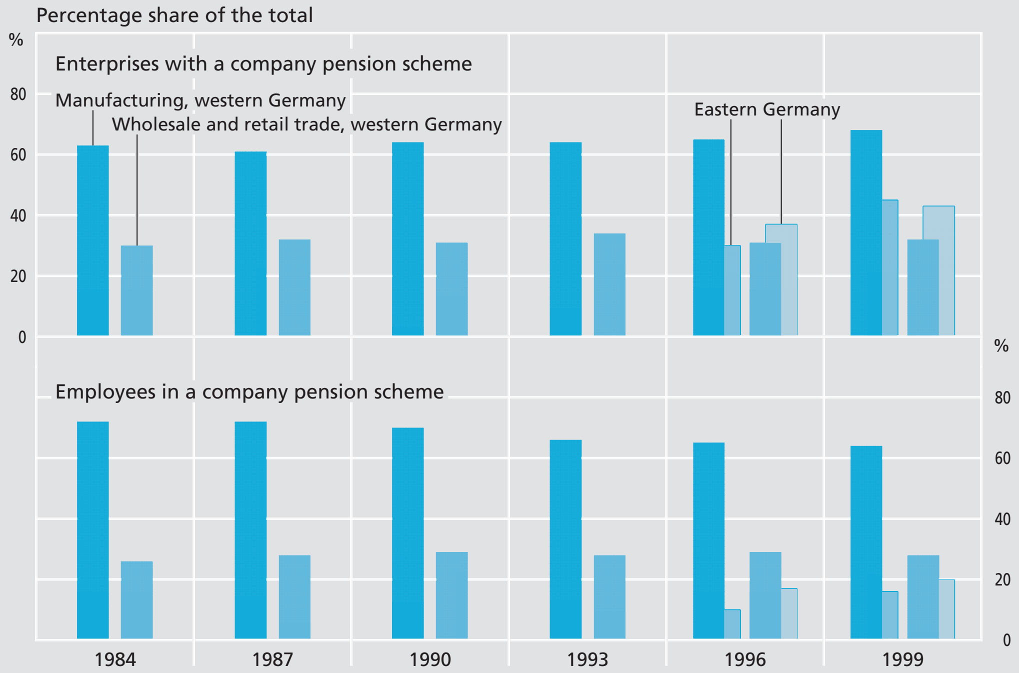
The Ifo surveys carried out at three-year intervals convey an impression of how widespread company pension schemes are. These surveys are, however, limited to the manufacturing and trade sectors and do not take account of the increasingly important services sector.[7] According to the last survey, conducted in 1999, 68 % of all manufacturing enterprises in western Germany had a company pension scheme. Of employees in this sector, 64 % were entitled to a company pension. In eastern Germany the spread in manufacturing (45 % of enterprises and 16 % of employees) was significantly lower. In contrast to manufacturing, company pension provision in the trade sector is considerably less developed. In the old Länder the portion of enterprises in this sector with a company pension scheme was only 32 %, with no major changes having taken place since 1984. In eastern Germany, however, relatively more wholesale and retail trade enterprises (43 %) offer a company pension scheme. This could be due to the fact that trading companies in the new Länder are relatively frequently set up as private limited companies (GmbH); in such companies it is common for there to be a company pension for management staff. This would also explain the fact that the proportion of employees entitled to a company pension in the east German wholesale and retail trade sector is, at 20 %, still lower than in western Germany (28 %).

Types of company pension scheme

The most important type of company pension provision is likely to continue to be the company-based scheme. The last extensive sampling by the Federal Statistical Office is, however, not very up-to-date. It relates to western Germany in 1990.[8] According to the data collected, 46 % of all employees across all parts of the private sector were in a pension scheme. Of the total figure for employees benefiting, 54 % were in a company-based

6 For instance, the most recent detailed comprehensive sample survey carried out by the Federal Statistical Office relates to 1990.
7 See Ruppert, Wolfgang, *Betriebliche Altersversorgung* – the eighth research initiative with regard to the situation and development of company pension schemes carried out on behalf of the Federal Ministry of Labour and Social Affairs, Ifo, February 2000.
8 See Federal Statistical Office, Subject-Matter Series 16, Series 6.2, data on the type and extent of company pension schemes, second collection as at December 31, 1990, 1995.

Spread of company pension schemes in Germany



Source: Ifo Institute for Economic Research.

Deutsche Bundesbank

scheme. Trailing well behind came staff pension insurance (19 %), direct insurance (14 %) and benefit funds (13 %). According to the size of the enterprise measured by the number of employees, it became apparent that, as types of company pensions provision, company-based pension schemes and benefit funds were more widespread in large companies, while staff pension insurance and direct insurance were more common in smaller enterprises.

Size of company pensions

As a source of income intended to supplement statutory pension provision, company pensions in the private sector are very unevenly distributed (see the table on page 51). According to a survey on pension provision in Germany,[9] in western Germany in 1995 1.4 million men and 0.5 million women aged 55 and over were paid a company pension. The average amount of DM 663 a month for men – measured on the "net standard pension"[10] of DM 1,933 a month – was quite considerable. The average company pension for a woman was, however, only DM 318. Moreover, the average figures are not very meaningful because the vast majority of people had far lower company pensions. For 68 % of men these were less than DM 500, while 57 % of women were drawing a pension of less than DM 200. Marked differences can also be seen according to the last position held. In 1995 the average monthly company

9 See Infratest Burke Social Research: *Alterssicherung in Deutschland 1995 (ASID '95).* The income of persons and married couples aged 55 and over, research project commissioned by the Federal Ministry of Labour and Social Affairs, 1998.
10 The pension of an average wage or salary earner who has paid into the statutory pension scheme for 45 years.

pension for male (female) salaried staff was DM 1,160 (DM 407) and for wage earners only DM 240 (DM 171).

Entitlement to a company pension

A further survey of men and women born between 1936 and 1955 gives information about future company pension provision (see the table on page 52).[11] This survey clearly shows that the current spread of company pensions will not change substantially in the foreseeable future. In the old Länder 36 % of men and 12 % of women employed in the private sector who are entitled to a statutory pension are also eligible for a company pension. In the new Länder these proportions were only 4 % (men) and 2 % (women). For those born in the aforementioned period the estimated monthly entitlement to a company pension in western Germany was, on average, DM 588 for men and DM 369 for women. At DM 506 and DM 347 respectively, the average amounts in eastern Germany were only slightly below those in western Germany.

There is also unlikely to be any great change in the uneven distribution in the immediate future. Company pensions will also be used less in future to boost below-average statutory pension provision claims than to top up higher social security pensions, with the scope for tax savings being of particular importance. For men and women born between 1936 and 1955, the proportion of persons looking forward to a company pension was

11 See Infratest Burke Social Research: *Altersvorsorge in Deutschland 1996 (AVID '96).* Life patterns and future income in retirement, research project commissioned by the Association of German Insurance Companies and the Federal Ministry of Labour and Social Affairs, 1999.

Spread and volume of company pension schemes in the private sector in 1995

Persons aged 55/65 and over, old Länder

Item	Own pensions		Derived pensions
	Men	Women	Widowed
Persons aged 55 and over			
Number of recipients (in thousands)	1,424	509	490
Disbursements (in DM per month) ranked by size, as a percentage			
up to 49	3	8	10
50 – 99	11	18	23
100 – 199	28	31	27
200 – 399	20	18	20
400 – 599	12	12	8
600 – 999	10	8	5
1,000 – 1,399	5	4	4
1,400 – 1,999	4	1	2
2,000 and above	7	1	1
Amount per recipient (in DM per month) 1			
1995	663	318	310
1992	652	316	306
1986	527	219	250
Persons aged 65 and over			
Amount per recipient (in DM per month) 1			
1995	605	316	316
Recipients, as a percentage share of the potential total 2			
1995	50	10	.
1992	50	10	.
1986	40	7	.

Source: Infratest Burke Social Research: *Alterssicherung in Deutschland 1995 (ASID '95).* — **1** Amount before any income tax assessment. — **2** Potential recipients: retired wage earners/salaried staff aged 65 and over in the private sector (excluding mining). The breakdown is not available for persons aged 55 and over.

Deutsche Bundesbank

Eligibility for benefits from company pension schemes in the private sector in 1996

Men and women born between 1936 and 1955

Item	Old Länder		New Länder	
	Men	Women	Men	Women
Persons eligible for a statutory pension (in thousands)	7,312	7,054	2,072	2,080
Persons eligible for a company pension in the private sector (in thousands)	2,643	863	80	40
Percentage eligible for a company pension 1	36	12	4	2
Breakdown of company pension eligibility according to volume 2 (in DM per month) 3				
up to 49	2	6	3	4
50 – 99	4	10	12	12
100 – 199	21	29	21	24
200 – 399	33	26	33	27
400 – 599	16	16	5	22
600 – 999	10	6	7	3
1,000 – 1,399	5	4	8	8
1,400 – 1,999	4	1	11	0
2,000 and above	5	2	1	0
Amount per recipient (in DM per month)	588	369	506	347

Source: Infratest Burke Social Research: *Altersvorsorge in Deutschland 1996 (AVID '96).* — **1** As a percentage of persons with projected statutory pension entitlement. — **2** As a percentage of persons with projected company pension entitlement. — **3** Disbursement after deduction of the pensioner's own contributions to health and nursing insurance and before any income tax assessment.

Deutsche Bundesbank

greater, as was its expected level, the higher the anticipated statutory pension. This finding is in keeping with the efforts by employers to provide better qualified employees, in particular, with a company pension entitlement in order to ensure that they stay with the company.

Company pensions as part of a compensation package ...

From the standpoint of the enterprise, expenditure financed by the employer for company pension provision is included in labour costs. According to the labour cost survey carried out by the Federal Statistical Office, 3.9 % of the total labour costs in manufacturing in 1996 were accounted for by company pension provision. In the trade sector, the corresponding value was, at 1.6 %, distinctly lower, and in the financial sector considerably higher, at 7.8 % (see the table on page 53). Average expenditure in the old Länder continued to be greater than in the new Länder. It also increased with the size of the enterprise. In all sectors reviewed taken together[12] the share of the total labour costs assumed by company pension provision was 3.9 %. It had scarcely changed since 1992 (3.8 %). The significance of company pension schemes in terms of labour costs has also stagnated. In particular, with greater opportunity for contributions to be deducted directly from employees' wages and the planned incorporation of this facility into the overall promotion of supplementary pension provision, company pension schemes are likely to become considerably more significant in the context of labour costs as a whole.

12 Manufacturing, wholesale and retail trade, and the financial sector.

Expenditure on company pension schemes by enterprises in selected sectors *

Item	1992 Old Länder	1992 New Länder	1992 Germany	1996 Old Länder	1996 New Länder	1996 Germany
Expenditure per full-time employee in DM						
Manufacturing	3,102	187	2,753	3,656	415	3,179
Wholesale and retail trade 1	996	100	931	1,195	326	1,102
Financial activity	6,873	853	6,365	8,548	3,386	8,022
Sectors reviewed, taken together	2,580	191	2,330	3,014	493	2,680
Enterprises with						
between 10 and 99 employees	597	146	549	706	266	620
between 100 and 999 employees	1,613	85	1,416	1,907	278	1,697
1,000 or more employees	4,696	372	4,336	5,906	1,376	5,556
Expenditure as a percentage of total labour costs						
Manufacturing	4.1	0.5	3.9	4.2	0.7	3.9
Wholesale and retail trade 1	1.7	0.3	1.6	1.7	0.6	1.6
Financial activity	7.5	1.6	7.2	8.1	4.3	7.8
Sectors reviewed, taken together	4.1	0.5	3.8	4.2	1.0	3.9

Source: Federal Statistical Office, survey of labour costs. — * Enterprises with ten employees or more. — 1 In 1992 wholesale and retail trade (excluding trade in motor vehicles and retail sale of automotive fuel); in 1996 wholesale trade (new Länder and East Berlin, including commission trade), retail trade (excluding trade in motor vehicles and retail sale of automotive fuel) and repairs of consumer durables.

Deutsche Bundesbank

... and as a source of finance

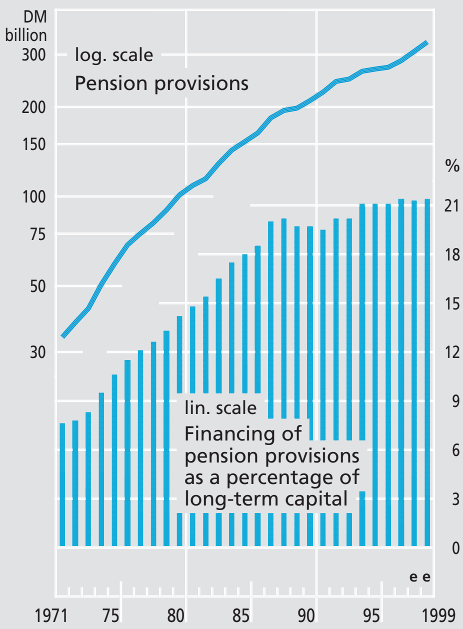
Company pension schemes put, on the one hand, a strain on current profit and loss accounts but, on the other, they do present the company with favourable financing options which are widely used. According to the Deutsche Bundesbank's corporate balance sheet statistics, the pension provisions of all enterprises covered were around DM 340 billion in 1999. This corresponded to just over 21 % of the capital available to enterprises long term.[13] The fact that this share has scarcely risen since the start of the 1990s is likely to have been partly due to the fact that, as a result of the significant fall in capital market rates, enterprises find this method of financing less attractive. In addition, this instrument is likely to have progressed from the growth phase to maturity. In funded pension schemes this always occurs if the targeted cover is attained and the periodic disbursements are roughly in line with contributions. Thereafter, the capital stock only grows on a par with overall economic growth.

Share of financial assets

From a macroeconomic perspective, company pension schemes make a significant contribution to the building-up of financial assets and thus indirectly to the financing of industrial investment. More specific data on the financial assets which are accumulated through company pension schemes are only available for pension provisions and staff pension insurance *(Pensionskassen).* The volume of assets tied in to benefit funds and direct insurance can, however, only be estimated.

13 This includes own funds and long-term loan capital.

Pension provisions and their significance for corporate financing



Deutsche Bundesbank

Up to the end of 1999, an overall capital stock of more than DM 600 billion is likely to have been built up in the context of company pension provision. This corresponded to around 5½% of the financial assets of the domestic non-financial sectors,[14] or 9% of the financial assets of private households (including non-profit institutions serving households). If assets built up by means of private life insurance policies and the relatively unimportant reserves of supplementary pension provision in the public sector[15] are added, institutional pension provision in Germany, thus defined, amounts to roughly 14% of the financial assets of the non-financial sectors or 23% of that of households. In the early 1990s these shares were 15% and 23% respectively. Since then, financial assets have expanded strongly, however, partly as a result of asset price increases. The importance of company pension provision has declined somewhat over time, while that of private life insurance, to which equally significant tax concessions apply, has grown steadily. Account must also be taken of the fact that other methods of saving for retirement that are not covered in this calculation may play a role.

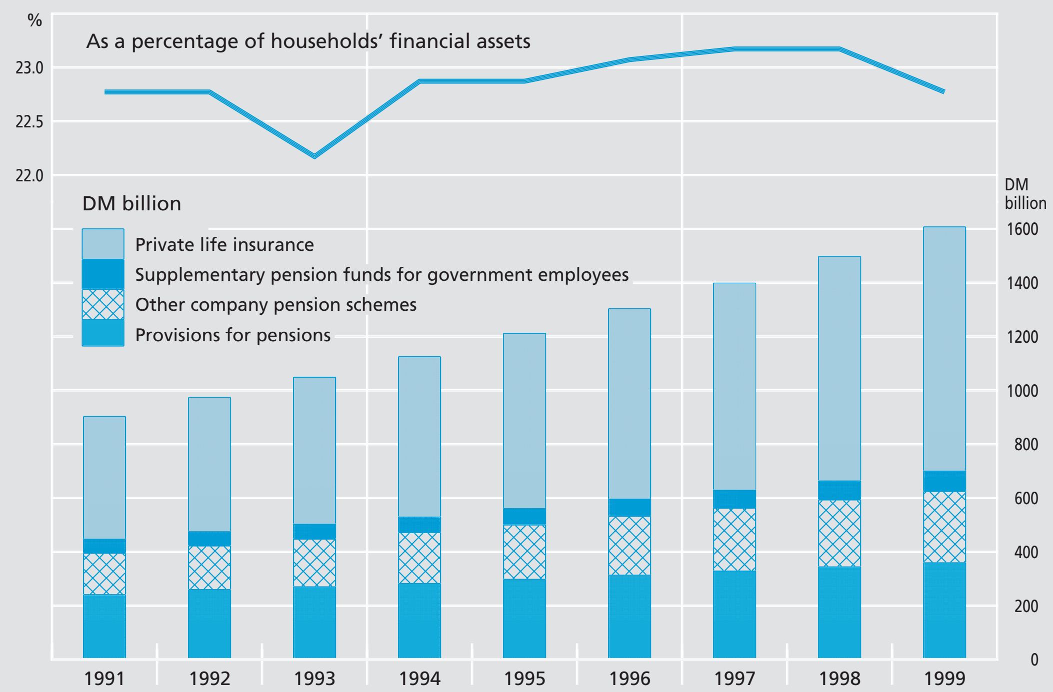
The impact of pension reform

Additional support for company pension schemes

The Bill promoting private pension plans, which as part of the pension reform[16] is still the object of mediation, mainly addresses the issue of state encouragement of private supplementary pension provision. Company pension schemes have been included in these promotion measures and have also been given special concessions.[17] In addition, new scope is also foreseen for company pension provision to be set up as a defined contribution scheme or a pension fund. Finally, employees are to be allowed to convert current or future portions of their compensation into a pension entitlement, although this is subject

14 Households plus non-profit institutions serving households, public authorities and non-financial corporations.
15 In addition to the pension fund for government employees, which has only relatively small reserves, this primarily includes supplementary pension funds established by local government and churches.
16 Changes in the benefits legislation relating to statutory pension provision are provided for primarily in the Act on Supplementary Pension Provision *(Altersvermögensergänzungsgesetz),* which did not require the approval of the Bundesrat.
17 Support for private pension contributions at the level of the individual is being introduced in four stages, with the upper limit in 2002 being only 1% of the income threshold for assessing contributions to the statutory pension scheme. In the context of company pension schemes, pursuant to section 3 number 63 of the Income Tax Act, the limit is 4% from the first year.

Financial assets in the context of institutional pension schemes



Deutsche Bundesbank

to such provision being included in a collective wage agreement proviso.[18]

Support for pension contributions ...

The provision made in the Income Tax Act to encourage contributions to pension schemes by means of direct grants or a special tax allowance (section 10a of the Income Tax Act) is also to apply to contributions to direct insurance, staff pension insurance and pension funds. This is, however, conditional upon the contributions being made from an employee's income that is subject to personal tax and social security contributions.[19] In addition, it remains possible, in the case of direct insurance and staff pension insurance, to take advantage of the 20 % flat rate of employee taxation of the contributions (up to DM 3,408 a year) pursuant to section 40b of the Income Tax Act. If contributions are deducted directly from the employee's wages, the related exemption of social security contributions is, however, to expire at the end of 2008. Pursuant to section 3 number 63 of the Income Tax Act, a further support option applicable only to company pension schemes is foreseen for staff pension insurance and pension funds in that contributions to these two types of pension scheme can be exempt of wage tax up to 4 % of the income threshold for assessing contributions to the statutory pension scheme. As in the case of flat-rate taxation,

18 If compensation claims are based on a collective wage agreement, contributions may be deducted directly from employees' wages only if this is provided for or permitted in the collective wage agreement.
19 It is to be possible to transfer existing entitlement to benefits from a company-based scheme or a benefit fund to one of the three types of pension scheme eligible for state support, without incurring liability to tax and social security contributions (section 3 number 66 of the Income Tax Act).

this is linked to exemption from social security contributions, which, if contributions are deducted directly from employees' wages, is to continue only until the end of 2008 (see the overview on page 57).

... and taxation of outflows

The various promotion measures have different consequences for the subsequent taxation of company pensions. Contributions that are encouraged by means of special tax allowances or grants lead to a retirement pension which – in line with the principle of the taxation of outflows – is fully liable to tax. In the case of flat-rate taxation of the contributions, subsequent disbursement is, by contrast, tax-exempt, or only the earnings portion is taxable in the case of an annuity pursuant to section 22 of the Income Tax Act.

Defined contribution

The amendments to the Occupational Pensions Act introduced by the Bill promoting private pension plans allow defined contributions for the first time. Benefits are thus measured only on the basis of the volume of employer contributions and the investment earnings on the capital market. In this case, the employer incurs no calculation risk but has no opportunity to attain a higher yield as in the case of defined benefits. In accordance with the now legally established "defined contributions with a minimum benefit", the employer gives an additional guarantee that when the pension payments begin, at least those contributions that have been made to a pension scheme are available for disbursement.

Pension funds

Pension funds are a further type of company pension scheme. Like direct insurance and staff pension insurance, these funds are monitored by the Insurance Supervisory Office, although the investment regulations are intended to be less stringent.[20] Specific regulation is to be conferred upon the Federal Government. In particular, investment within the enterprises operating the funds is to be limited, as in the case of direct insurance and staff pension insurance. Whether these pension funds will comply with the European Commission's pension funds directive – which is currently only available in draft form – cannot be finally determined because the legal basis has yet to be established by both parties.

Strengthening the role of the capital market

All in all, from the perspective of capital market policy, reinforcement of the external types of company pension scheme has advantages. The "lock-in" effects of in-house forms of pension provision are thus reduced and the allocation function of the capital market strengthened. In particular, the introduction of pension funds has the effect of increasing the amount of freedom a company has when structuring its own company pension scheme. A balance needs to be found between investment security requirements and yield opportunities – taking into account the typically long investment time frame.

Generous concessions

The concessions foreseen by the Bill promoting private pension plans are generous. From 2008 an average wage-earner who, in addition to the tax exemption pursuant to sec-

20 In particular, pursuant to section 54a of the Act on the Supervision of Insurance Enterprises *(Versicherungsaufsichtsgesetz),* insurance companies may not invest more than 30 % of their tied capital in shares.

Treatment of company pension schemes under tax and social security legislation

New rulings are shown in bold type

Type of pension scheme	Treatment of contributions under tax and social security legislation: Income tax	Social security contributions: Financed by employer	Social security contributions: Direct deductions from employees' wages	Tax treatment of the return flows [1] to employees
Company-based scheme (*Direktzusage*)	Fully tax-exempt at company level (pension provisions) and for the employee (no inflow pursuant to section 11 of the Income Tax Act (*Einkommensteuergesetz, EStG*)	For the employee, compensation not subject to compulsory insurance, as no inflow pursuant to section 11 of the Income Tax Act		As income from employment pursuant to section 19 (1) 2 of the Income Tax Act [2]
Benefit fund (*Unterstützungskasse*)	Tax exemption at company level limited to cash holdings (operational expenditure), tax-exempt for the employee (no inflow pursuant to section 11 of the Income Tax Act)			
Reinsured benefit fund (*Rückgedeckte Unterstützungskasse*)	Fully tax-exempt at company level (operational expenditure) and for the employee (no inflow pursuant to section 11 of the Income Tax Act)			
Direct insurance (*Direktversicherung*)	Tax-exempt operational expenditure at company level, flat rate of tax pursuant to section 40b of the Income Tax Act: 20 % [3] for the employee	Exemption from tax or social security contributions pursuant to section 2 (1) 3 of the Employment Compensation Regulation (*Arbeitsentgeltverordnung*)	**Exemption from tax or social security contributions until the end of 2008 pursuant to section 2 (1) 3 of the Employment Compensation Regulation**	Taxation of the earnings portion pursuant to section 22 number 1 of the Income Tax Act
	Special tax allowance or grant pursuant to section 10a of the Income Tax Act [4]	**Expenditure from "contributive" compensation: no exemption from tax or social security contributions**		**Taxable as outflow under "other income" pursuant to section 22 number 5 of the Income Tax Act**
Staff pension insurance (*Pensionskasse*)	Tax-exempt operational expenditure at company level, flat rate of tax pursuant to section 40b of the Income Tax Act: 20 % [3] for the employee	Exemption from tax or social security contributions pursuant to section 2 (1) 3 of the Employment Compensation Regulation	**Exemption from tax or social security contributions until the end of 2008 pursuant to section 2 (1) 3 of the Employment Compensation Regulation**	Taxation of the earnings portion pursuant to section 22 number 1 of the Income Tax Act
	Tax-exempt operational expenditure at company level, up to 4 % of the income threshold [5] tax-exempt for the employee pursuant to section 3 number 63 of the Income Tax Act	**Exemption from tax or social security contributions pursuant to section 2 (1) 5 of the Employment Compensation Regulation**	**Exemption from tax or social security contributions until the end of 2008 pursuant to section 2 (1) 5 of the Employment Compensation Regulation**	**Taxation as outflow under other income pursuant to section 22 number 5 of the Income Tax Act**
	Special tax allowance or grant pursuant to section 10a of the Income Tax Act [4]	**Expenditure from "contributive" compensation: no exemption from tax or social security contributions**		
Pension fund (*Pensionsfonds*)	**Tax-exempt operational expenditure at company level, tax-exempt for the employee up to 4 % of the income threshold [5] pursuant to section 3 (63) of the Income Tax Act**	**Exemption from tax or social security contributions pursuant to section 2 (1) 5 of the Employment Compensation Regulation**	**Exemption from tax or social security contributions until the end of 2008 pursuant to section 2 (1) 5 of the Employment Compensation Regulation**	
	Special allowance or grant pursuant to section 10a of the Income Tax Act [4]	**Expenditure from "contributive" compensation: no exemption from tax or social security contributions**		

1 Company pensions are generally subject to statutory health and nursing insurance contributions. — **2** Taking account of the tax-free portion of 40 % of the disbursements and a maximum of DM 6,000 a year pursuant to section 19 (2) of the Income Tax Act. — **3** Plus solidarity surcharge and, as appropriate, church tax. Upper limit for tax recognition purposes: DM 3,408 a year. — **4** A graduated timescale for the special tax allowance (1 % of the income threshold for assessing contributions from 2002, 2 % from 2004, 3 % from 2006 and 4 % from 2008) and for grants. — **5** Income threshold for assessing contributions to statutory pension insurance (2001: DM 104,400 a year, or DM 8,700 a month).

Deutsche Bundesbank

tion 3 number 63 of the Income Tax Act, also claims the additional special tax allowance pursuant to section 10a of the Income Tax Act, would be able to make tax-free contributions to a company pension scheme up to a maximum of around 15 % of his/her income – an amount that is, as a rule, unlikely to be fully exploited. However, in the case of "more savings-eligible" income in the amount of the income threshold for assessing contributions to statutory pension provision, this rate is still 8 %. Given a private saving ratio of around 10 %, the tax advantages are likely to be exploited by all and sundry. Overall, the Federal Government budget will be stretched. Coupled with the promotion of private retirement provision, tax shortfalls of DM 20 billion a year must be expected in the final phase. Moreover, the tax incentives that already exist for company pension provision and private life insurance will continue to be claimed.

Outlook

Growing importance

Following a time of stagnation in recent years, company pension schemes, as the second pillar of provision for retirement, could play a more significant role in Germany in future. The unavoidable reduction of the level of benefit in the statutory pension provision needed if the rise in contribution rates is to be curbed will make supplementary private provision necessary to the extent that the more slowly rising pension increases, now approved, were not anticipated. Company pension schemes are a suitable way of making up for provision shortfalls. However, the new concessions also provide a boost for private pension provision to expand. Basically, the goal should be equal tax treatment of all types of pension provision, which would also enhance transparency.

Support needed for people with lower incomes

So far company pension schemes have tended to be a means of safeguarding the standard of living of higher-earners, this having been jeopardised by the income threshold for assessing contributions to the statutory pension scheme. In future it will be increasingly vital for additional private pension provision options to be made available to people in the lower income brackets, as they are less able to save and, moreover, the economic self-interest of the employer in offering a company pension scheme for this wage bracket is likely to be fairly minor. It therefore seems logical for greater incentive to be given to lower-earners by introducing grants. The generous tax concessions for all income groups are likely, however, to be exploited to a considerable extent by those who would have made provision for their retirement anyway. In terms of fiscal policy, the task is to accommodate within the desired budgetary consolidation the large additional revenue losses generated by the promotion measures, particularly as they will increase sharply over the medium-term planning horizon.