Outlook for Germany's statutory pension insurance scheme

Demographic developments are making adjustments in the statutory pension insurance scheme unavoidable if the sustainability of the system is to be ensured. The comparatively far-reaching reforms of the past ten years, which are designed to cover the period up to 2030, have given due consideration to this. For example, an increase in the contribution rate is foreseeable. However, this increase is to be limited by a decreasing relative pension level and a rising retirement age. Nevertheless, the rates of return in the pay-as-you-go system will decline and therefore place a burden on younger generations. All in all, private pensions are expected to become more important in the area of old-age provisions.

Long-term projections and reliable early policy decisions are essential if there is to be confidence in the pension insurance scheme and certainty about planning for retirement provision. It is therefore reasonable to include a timely consideration of the prospective challenges after 2030. As there are likely to be further increases in life expectancy, the retirement age does not seem to be the least important adjustment parameter for the future. Ad hoc improvements in benefits, by contrast, postpone additional burdens to a later date and ultimately put the reliability of the system at risk.

Basic features of the statutory pension insurance scheme[1]

Statutory pension insurance scheme on pay-as-you-go basis

In Germany, financial retirement provisions are dominated by the statutory pension insurance scheme, which accounts for the vast majority of current retirement provisions and is compulsory, particularly for wage and salary earners.[2] It operates on a pay-as-you-go basis, which means that the income from current pension contributions is used immediately to pay out pension benefits to the current pensioners. In this case, the reserves have the purpose of securing liquidity within a given year and bridging cyclical fluctuations in revenue preferably without changes in the contribution rate.

Participative equivalence distinguishes pension contributions from general taxes

The level of the statutory pension acquired from own contributions reflects – in accordance with the principle of participative equivalence – the relative income position during working life. Higher compulsory contributions result in proportionally higher pension entitlements. This concrete compensation and the insurance nature of the scheme distinguishes the pension insurance contribution from a tax. In this case, the attractiveness of a pension scheme is not so much based on the level of benefits but rather on the ratio between contributions made and later pension benefits, ie the insurance return. If the ratio of contributors to pensioners falls, owing to lower birth rates, for example, this by itself leads to lower rates of return in the pay-as-you-go system.

Central factors in statutory pension insurance scheme

The pension level, the statutory retirement age, the contribution rate (as well as the definition of the assessment basis) and the Federal grant are decisive factors in the financial development of the pension insurance scheme. For example, the current ratio of the gross standard pension[3] to the gross average earnings per employee is just over 47%. After taxes and social security contributions about 65½% of net earnings are reached.[4] The contribution rate to be paid in equal portions by employers and employees is 19.9%, and the income limit, up to which income is included in the pension insurance scheme, is currently €5,300 per month in western Germany and €4,500 in eastern Germany. The statutory retirement age is 65 years. In 2007, the tax-financed Federal grant was 28½% of the expenditure of the pension insurance scheme. This expenditure amounted to €236 billion

1 In this article, the statutory pension insurance scheme is understood to be the general pension insurance scheme excluding the miners' pension insurance fund.
2 In 2003, about six-tenths of the current retirement provisions came from the pension insurance scheme, just over one-tenth from civil service pensions and another one-tenth from different forms of occupational pensions. Other retirement provisions, mainly interest and rental income and income from employment, accounted for almost two-tenths. However, this does not take into account the consumption of existing wealth or rent-free accommodation in owner-occupied housing, which means that the actual consumption possibilities in old age are underestimated significantly. See Alterssicherungsbericht (pension report) 2005, Bundestags-Drucksache 16/906, p 256.
3 Pension entitlement with 45 pension entitlement points (eg average earner with 45 years of contributions).
4 This is based on a single person without further income. Owing to the gradual conversion to the downstream taxation of pension outflows, it has not been possible to calculate a standard net pension level for all new pensioners since 2005. The statutory target for the level of benefits from the pension insurance scheme is the "security level before taxes", which is defined as the quotient obtained by dividing the standard pension less the pensioner's health and long-term care insurance contributions by the average earnings derived from the national accounts less the corresponding social security contributions (including assumed expenditure on additional retirement provisions). The current level of 51% is not to fall below 46% until 2020 and not below 43% until 2030 (section 154 (3) number 2 of the Sixth Book of the Social Security Code (Sozialgesetzbuch)).

last year, which is almost 10% of gross domestic product (GDP) or 23½% of general government expenditure.

Financial development since turn of millennium[5]

Difficult financial development until 2005

Over the past ten years, the financial development of the statutory pension insurance scheme was marked by a significant increase in the Federal grants and numerous measures with a short-term financial effect. The reserves were almost completely used up by 2005 and were not built up again until later.

Tax financing increases

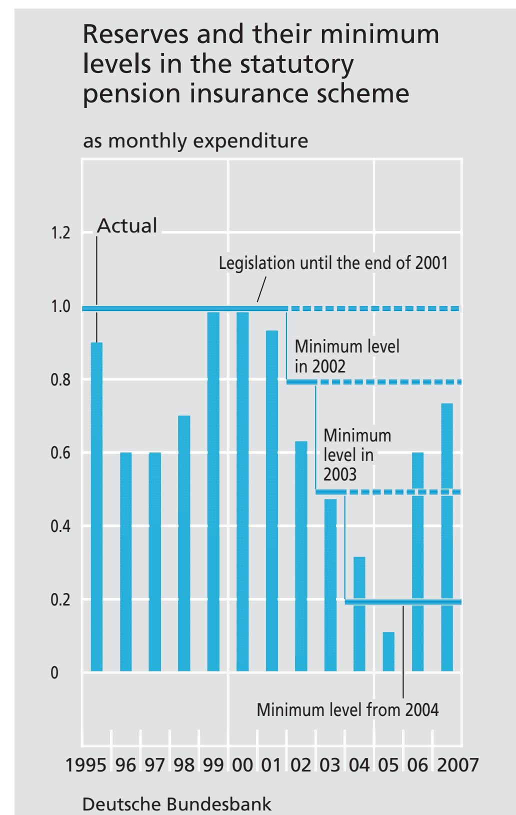
Since 1998, the Federal Government has increasingly participated in the financing of the statutory pension insurance scheme. For example, the Federal grants were first considerably increased in the course of a VAT increase and again in connection with an increased taxation of energy consumption. In addition to the Federal grants, contributions to cover child-rearing periods are also now credited. All in all, the additional tax financing in recent years is equivalent to about 3 percentage points of the revenue in contribution rates. In total, the grants to the statutory pension insurance scheme (excluding the miners' pension insurance fund) amount to about one-quarter of the Federal budget.

Depletion of reserves owing to ongoing deficits

With the aid of the increased Federal grants, it was possible to reach the reserve target of one month's expenditure almost exactly in the cyclically favourable years 1999 to 2000 and reduce the contribution rate to 19.1% in 2001. However, the following period of sluggish growth and the continuing increase in the number of pensions led to substantial deficits which depleted the reserves. One of the ways Parliament reacted to this was to gradually reduce the minimum reserve requirement to 0.8 of monthly expenditure in 2002 and ultimately to 0.2 of monthly expenditure in and since 2004, while in 2003 the contribution rate was raised to 19.5%. At the end of 2005, the financial reserves reached their historical low, with just 0.1 of monthly expenditure. It was not until 2006 that the financial situation eased again, but this was solely due to the advancement of the deadlines for transferring social security

Reserves and their minimum levels in the statutory pension insurance scheme

as monthly expenditure



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5 For earlier developments, see Deutsche Bundesbank, Prospects for, and obstacles to, a stronger reliance on funding in the statutory system of old-age provision in Germany, Monthly Report, December 1999, pp 15-31.

Financial development of the statutory pension insurance scheme *

Item	1999	2000	2001	2002	2003	2004	2005	2006	2007 p
Income	€ bn								
Total contributions	152.21	150.71	152.05	152.81	156.51	156.53	156.26	168.08	162.22
Compulsory contributions	137.86	139.05	140.29	140.50	143.23	143.30	142.84	155.53	153.57
Contributions paid on behalf of unemployed persons	10.70	8.20	8.32	9.13	10.00	10.14	10.54	9.74	5.77
Other contributions	3.65	3.46	3.44	3.18	3.29	3.09	2.88	2.81	2.88
Transfers from the Federal budget	49.49	53.87	57.54	60.88	65.74	66.21	66.53	66.30	67.56
General Federal grant	34.56	33.34	33.83	34.79	36.59	37.10	37.49	37.45	38.15
Additional Federal grant	7.98	9.08	12.18	14.48	17.28	17.26	17.32	17.46	17.86
Contributions to cover periods of child-rearing	6.95	11.45	11.53	11.61	11.87	11.84	11.72	11.39	11.55
Other income	6.48	6.55	7.34	7.87	7.12	8.94	6.64	6.85	6.39
Total 1	208.17	211.14	216.93	221.56	229.37	231.68	229.43	241.23	236.17
Expenditure									
Pension payments	173.58	179.23	184.73	191.13	196.04	198.59	199.87	200.46	201.92
Pensioners' health insurance contributions	12.96	13.36	13.76	14.50	15.18	14.26	13.44	13.05	13.66
Administrative expenditure	3.23	3.39	3.52	3.65	3.73	3.74	3.77	3.61	3.46
Other expenditure 2	13.53	14.58	15.49	16.41	16.42	16.42	16.28	16.54	16.04
Total 1	203.30	210.56	217.50	225.69	231.36	233.01	233.36	233.67	235.08
Surplus (+) or deficit (-)	4.87	0.58	– 0.57	– 4.13	– 1.99	– 1.33	– 3.93	7.56	1.08
Financial reserves	13.58	14.20	13.78	9.72	7.48	5.04	1.71	9.74	11.71
Memo item: as a percentage of a month's expenditure	1.00	1.00	0.93	0.63	0.48	0.32	0.11	0.61	0.74
Income	Annual percentage changes								
Total contributions	0.0	– 1.0	0.9	0.5	2.4	0.0	– 0.2	7.6	– 3.5
Compulsory contributions	0.7	0.9	0.9	0.1	1.9	0.1	– 0.3	8.9	– 1.3
Contributions paid on behalf of unemployed persons	– 7.5	– 23.3	1.4	9.8	9.4	1.5	4.0	– 7.6	– 40.8
Other contributions	– 5.7	– 5.2	– 0.8	– 7.4	3.4	– 6.1	– 6.7	– 2.6	2.6
Transfers from the Federal budget	17.6	8.9	6.8	5.8	8.0	0.7	0.5	– 0.3	1.9
General Federal grant	– 7.0	– 3.5	1.5	2.8	5.2	1.4	1.0	– 0.1	1.9
Additional Federal grant	62.5	13.8	34.1	18.9	19.3	– 0.1	0.3	0.8	2.3
Contributions to cover periods of child-rearing	–	64.7	0.7	0.7	2.2	– 0.3	– 1.1	– 2.7	1.3
Other income	41.2	1.1	12.0	7.3	– 9.6	25.6	– 25.8	3.2	– 6.7
Total 1	4.6	1.4	2.7	2.1	3.5	1.0	– 1.0	5.1	– 2.1
Expenditure									
Pension payments	3.1	3.3	3.1	3.5	2.6	1.3	0.6	0.3	0.7
Pensioners' health insurance contributions	3.9	3.2	3.0	5.3	4.7	– 6.0	– 5.8	– 2.9	4.6
Administrative expenditure	2.8	4.8	3.8	3.8	2.1	0.4	0.7	– 4.2	– 4.1
Other expenditure	2.3	7.7	6.2	6.0	0.1	0.0	– 0.9	1.6	– 3.0
Total 1	3.1	3.6	3.3	3.8	2.5	0.7	0.1	0.1	0.6

* Up to 30 September 2005: wage and salary earners' pension insurance scheme; from 1 October 2005: German pension insurance scheme excluding "Deutsche Rentenversicherung Knappschaft – Bahn – See". — **1** Excluding payments under the revenue-sharing scheme. — **2** In particular, payments to the miners' pension insurance fund and rehabilitation expenses.

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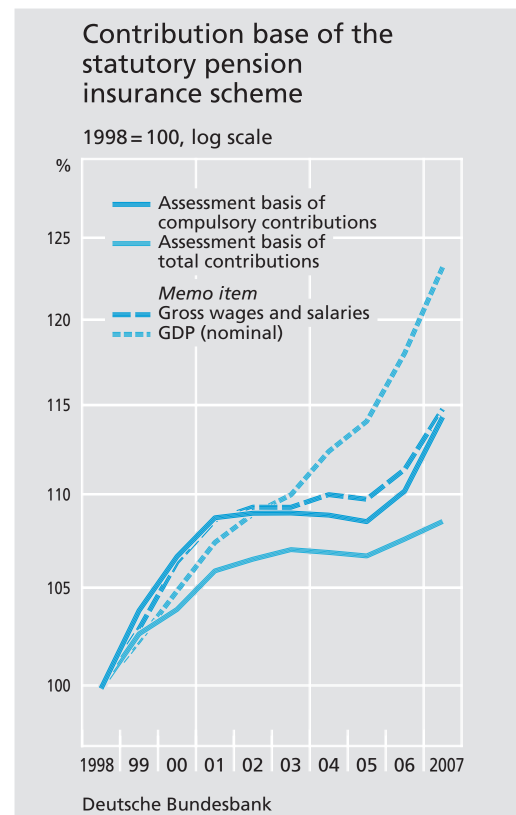
contributions and the resulting one-off collection of almost 13 monthly contributions. With a surplus of €7½ billion, it was therefore possible to increase the reserves to 0.6 of monthly expenditure again, but the underlying loss-making performance remained. On 1 January 2007, the contribution rate was therefore increased from 19.5% to 19.9%. Thus, together with the favourable employment trend and the relatively few retirements at the time, it was possible to increase the financial reserves at the end of 2007 to just over 0.7 of monthly expenditure (€11½ billion).

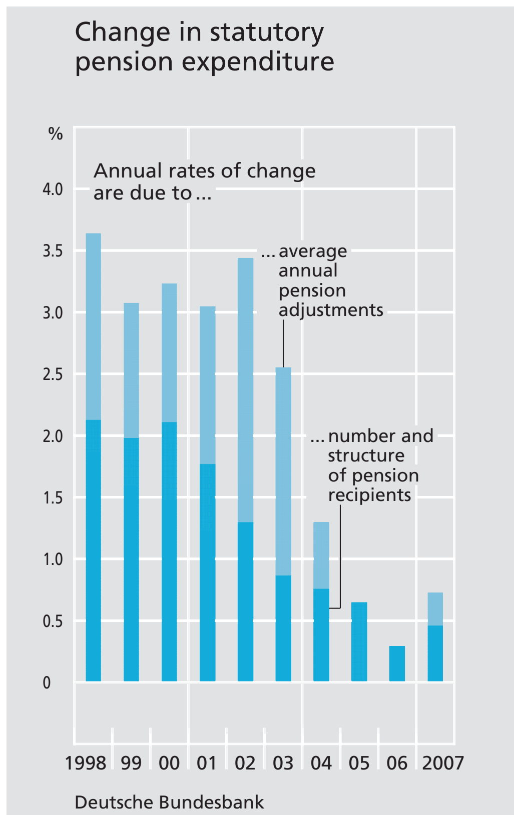
Weak development of contribution base

The revenue side particularly reflected the development of gross wages and salaries whose average growth was less than that of GDP. From 1998 to 2007, annual nominal GDP growth averaged almost 2½%, whereas total gross wages and salaries as well as the compulsory contributions of employees adjusted for contribution rate changes rose by no more than an annual 1½%. In total, the adjusted contribution revenue increased by only just under 1% on an annual average. The main reason for this was the lower revenue – partly as a result of new legislation – from the contributions for recipients of unemployment benefits.

Strong initial expenditure growth gives way to marked slowdown

At an annual average of 2%, expenditure growth over the past ten years has been higher than that of the contribution base. The relatively strong increases up to 2003 (just over 3% per year) were followed by years with comparatively low rates of increase (½%). Both the smaller pension adjustments and the recently lower number of people entering retirement as well as structural changes in the form of lower average pensions were key factors in the slowdown. The fact that since 1 April 2004 the pension insurance scheme has no longer covered half of the contribution for the long-term care insurance of pensioners added to the slowdown in the rise in expenditure. Since 1 July 2005, pensioners, like all other insured persons, have had to pay a special contribution towards the statutory health insurance scheme amounting to 0.9% of their pension. The contribution rate to be paid in equal portions by the statutory pension insurance scheme and the pensioners has been reduced by the same percentage.





Demographic developments require adjustments

Demographic changes unfavourable for pension insurance scheme

Developments since the mid-1990s have given an initial impression of the impending demographic changes. For example, the ratio of persons aged 65 and over to those aged 20 to 64 (elderly dependency ratio) has risen after a prolonged period of relative stability from 25% in 1995 to 33% at present. This is due to the fact that the much lower number of persons born since the end of the 1960s has reached working age and the relatively high number of persons born between 1930 and 1940 has reached retirement age. While the elderly dependency ratio is more or less stable at present, the increase in the percentage of elderly people in the population will accelerate notably from the middle of the next decade. According to the most common assumptions, the elderly dependency ratio will rise to 50% by 2030 and to as much as 60% by 2050.[6] One reason for this is the continuously low birth rate. Another reason is that the continually rising life expectancy steadily increases the group of older persons. For example, it is now assumed that the further life expectancy of 65-year-old women will rise from 20 years at present to 22½ years by 2030 and to 24½ years by 2050. For men, a rise from currently 16½ years to 19 years in 2030 and to 21 years by 2050 is expected.

Adjustment options within statutory pension insurance scheme

This development will have a significant financial impact on the statutory pension insurance scheme operating on a pay-as-you-go basis. In order to stabilise the system, it is necessary to start by making changes to the central factors of contribution rate, pension level, retirement age or Federal grant. In view of foreseeable developments, various changes – especially those affecting the future – have been agreed in the past years (see the annex on pages 65ff). For example, the financial sustainability up to 2030 is to be achieved through a rising contribution rate, a falling (relative) pension level and a higher statutory retirement age. Ultimately, the content and timing of the features will decide on how the burdens from the decreasing rates of

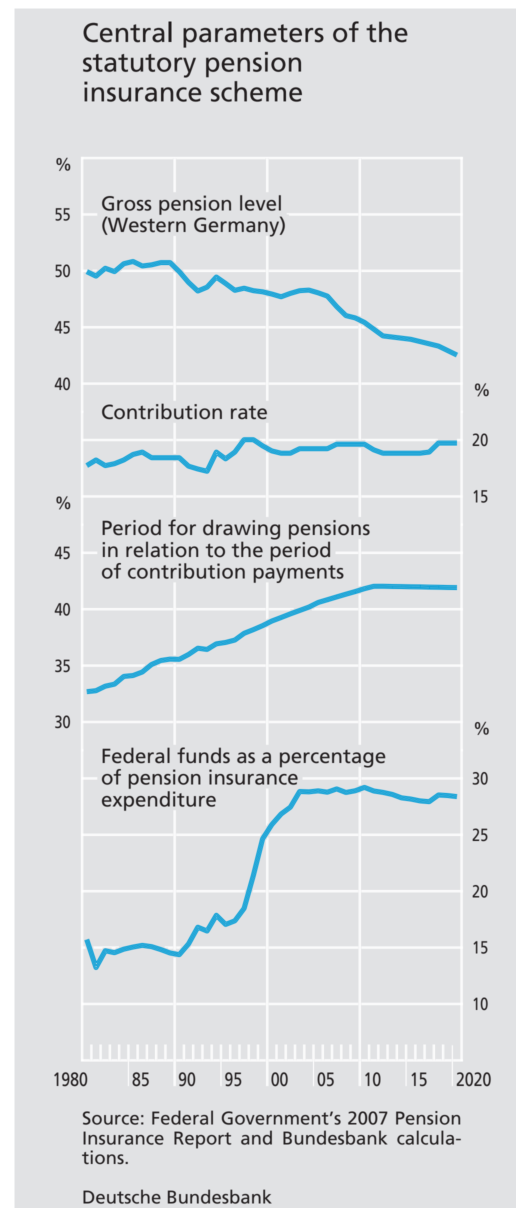
6 See Federal Statistical Office, Germany's population by 2050. Results of the 11th coordinated population projection, Wiesbaden, 2006. The figures stem from variant 1-W2 which serves as a basis for the Federal Government's pension forecasts (average rise in life expectancy at birth to 83.5 years for men and 88.0 years for women, almost constant birth rate of 1.4 and annual net immigration of 200,000 persons). The variant with 100,000 net immigrants per year makes the elderly dependency ratio rise to 52% by 2030 and 64% by 2050.

return of the system are distributed among the different generations.[7]

Contribution rate

"Overload protection" aimed to avert unchecked rise in contribution rate

With a prescribed Federal grant, retirement age and pension level, the contribution rate must be set so that there is sufficient current income to finance the current pension benefits and meet a target band for reserves. Without any further precautionary measures, the adjustment burden would fall on the contribution payers alone. However, the reform of 2001 introduced a formal overload protection. Thus, maximum contribution rates of 20% up to 2020 and of 22% up to 2030 were stipulated by law. Accordingly, the average annual contribution rate in working years will – through measures in other areas – rise less rapidly than previously assumed but nevertheless continuously. If this rate was 17.6% for a pensioner who had paid contributions for 45 years and entered the retirement phase in 2005, it would be about 19% for a retirement starting in 2015 and presumably 19½% in 2030.



Source: Federal Government's 2007 Pension Insurance Report and Bundesbank calculations.

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Pension level

Slower rise in pensions mainly as a result of supplementary private pension schemes ...

The individual pension level, ie the ratio of the respective payable pension amount to the average level of remuneration in the overall economy, is gradually declining owing to the change in the formula for the annual adjustment. Since 2002, pensions have increased in line with the rises in gross remuneration per employee in the previous year after adjustment for changes in the pension insurance contribution and a presumed remuneration component used for private pension schemes

7 The benefit restrictions in the statutory pension insurance scheme are to be applied with the same effect to civil service pensions. The Act on the Reorganisation of Service Regulations (Dienstrechtsneuordnungsgesetz) aims particularly at modelling the raising of the statutory retirement age and the cuts in the benefit level in civil service pension legislation.

(Altersvorsorgeanteil[8]*)*. The gradual increase in this component by ½ percentage point per year was to enable only a slight dampening of the general pension adjustment by mid-year in each case.

... and sustainability factor

In 2004, the pension adjustment formula was supplemented by a sustainability factor, because the contribution rate targets would otherwise not have been achievable, especially as a result of more unfavourable demographic assumptions from the perspective of the pension insurance scheme.[9] In this case, the sustainability factor reduces the extent of the pension adjustment in principle if the ratio of pensioners to contribution payers rises.[10] As a result of demographic ageing, the sustainability factor will therefore reduce the pension level in the longer term. However, if there is a structural increase in labour participation, this effect is weakened. Moreover, employment fluctuations in the economic cycle no longer have an effect on the pension adjustment through changes in the contribution rate alone. For example, the pension increase on 1 July 2007 was 0.2 percentage point higher via the sustainability factor as a result of the sharp rise in employment in 2006, and a similar effect is evident this year. All in all, the statutory pension insurance scheme has therefore become less dependent not only on the demographic changes but also on structural and cyclical employment fluctuations as a whole.

Retirement age

Gradual rise in statutory retirement age ...

A gradual rise in the statutory retirement age from 65 to 67 years was decided last year. From 2012, it will rise first by one month per year and then from 2024 by two months per year. Insured persons who turn 65 in 2029 will then have to wait two more years before they can receive a pension without deductions. Owing to this measure, which affects both the income and expenditure side, it should be possible to set the contribution rate ½ percentage point lower in 2030. This calculation already includes an exception for insured persons who have paid compulsory contributions for at least 45 years. They can still receive a pension without deductions at the age of 65. However, this privilege not only constitutes a breach of the principle of equivalence but also gives rise to considerable costs which are primarily to be financed by the other insured persons and which clearly limit the effectiveness of the measure in reducing the contribution rate.[11]

... but systematically inconsistent and costly exception

Higher retirement age corresponds to rising life expectancy

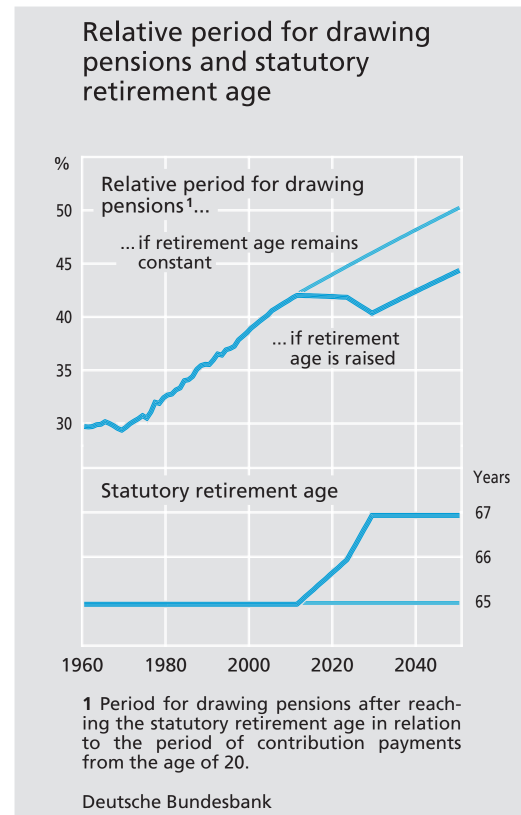
The raising of the statutory retirement age means a restriction on benefits compared with the status quo, because pension deductions need to be accepted if insured persons

8 This remuneration component tries to take the presumed increase in private pension payments by contribution payers into account so that adjustments can be kept to a minimum. The component was originally meant to rise in stages from 0.5% in 2002 to 4.0% in 2009. Owing to the increasing component, the pension adjustment for the respective year is reduced by just over 0.6 percentage point.
9 See Federal Ministry of Health and Social Security, Nachhaltigkeit in der Finanzierung der Sozialen Sicherungssysteme, Bericht der Kommission, Berlin, 28 August 2003 ("Rürup-Kommission").
10 This is based on the ratio of the number of paid standard pensions (calculated by dividing pension expenditure by the amount of the standard pension) to the number of average earners (calculated by dividing the contribution revenue from employed and unemployed persons by the pension contribution paid by the average earner).
11 See Gutachten des Sozialbeirats zum Rentenversicherungsbericht 2006 (Bundestags-Drucksache 16/3700), item 28 ff.

do not change their retirement behaviour and less additional mark-ups will be granted if they postpone their retirement to the current statutory retirement age. However, it must be remembered that there would otherwise be an ongoing expansion of benefits, because the pensions would be paid for increasingly longer times owing to rising life expectancy and the ratio to the paid contributions themselves would continue to increase.

Rising life expectancy will inevitably affect retirement age

It therefore seems reasonable to at least stabilise the ratio of the period for drawing pensions to the length of active working life. In this way, it might be possible to mitigate the pressure that rising life expectancy puts on the contribution rate. In actual fact, however, the relative period for drawing pensions for both men and women[12] increased from 30% in 1970 to almost 41½% in 2007. If the statutory retirement age remained unchanged at 65, this would result in a further increase to just over 46% in 2030 and just over 50% by 2050 (see chart above). By contrast, with the gradual raising of the statutory retirement age to 67, the relative period for drawing pensions in 2030 would be similar to now, namely about 41%. By 2050, however, it would then rise again if life expectancy continued to increase. This would indicate the necessity of raising the retirement age further even after 2029.[13] A gradual rise to 68½ years would keep the relative period for drawing pensions constant at the 2030 level until about 2050. A regular increase in the retirement age linked to the rising life expectancy might be able to create planning certainty for all parties involved.



Actual retirement age largely irrelevant for financing pensions – but not for government budget and overall economy

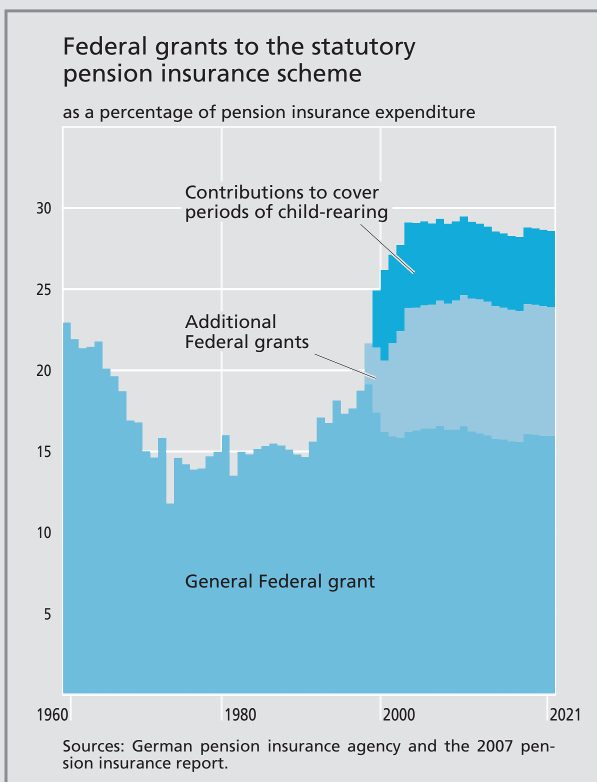
The finances of the pension insurance scheme are mainly affected by the statutory retirement age. Where the mark-downs for early retirement (currently 3.6% per year) and the mark-ups for postponed retirement (6% per year) are appropriate in actuarial terms, the actual retirement age – regardless of temporary costs and benefits – is largely irrelevant for the financial situation of the statutory pension insurance scheme.[14] However, for the stabilisation of public finances as a whole (taxes and social contributions) and of aggre-

12 Duration of drawing pensions starting at the statutory retirement age in relation to the duration of contribution payments starting at the age of 20.
13 See Comments by the Deutsche Bundesbank presented to the Committee on Labour and Social Affairs of the Deutsche Bundestag, printed in Monthly Report, March 2007, pp 10-11.
14 See Johannes Clemens, Anhebung der Regelaltersgrenze und Abschläge bei vorzeitigem Renteneintritt, Wirtschaftsdienst, 12/2007, pp 835-840.

Federal grants to finance non-insurance-related benefits provided by the statutory pension insurance scheme

Tax-financed grants to the statutory pension insurance scheme were originally justified in an explanatory memorandum of 1888, largely on the grounds that a lower level of poverty in old age would provide relief in other budget areas. Under the subsequent pension reform of 1957, by contrast, the aim was to offset any expenditure incurred by the statutory pension insurance scheme that did not represent benefits under old-age provision. In the case of the 1992 pension reform, Parliament dispensed with an explicit justification for such Federal grants. However, the additional Federal grant introduced in 1998 was specifically designed to facilitate a flat-rate reimbursement of benefits not covered by contributions (section 213 (3) of the Sixth Book of the Social Security Code).

In 1960, Federal grants constituted 23% of pension insurance scheme expenditure. This was followed by a marked decline in the ratio which was due to the fact that, while Federal grants were consistently adjusted in line with growth in per capita wages, pension expenditure rose at a much faster rate. As a result, the contribution rate was raised from its initial level of 14% to 18% in 1974. Since the introduction of the 1992 pension reform general Federal grants have shadowed the product of average remuneration and the contribution rate, ie contributions derived from unchanged employment. Hence, the negative labour market developments which arose in the years following German reunification caused Federal grants to expand at a rate that outstripped growth in contributions received, and the former's share of (total) financing to go up accordingly. Additional funding has been available since 1998 in the form of the additional Federal grant, supplemented in 1999 by contributions to cover child-rearing periods, meaning that currently just under 30% of funding for pension insurance expenditure is provided by central government.



Sources: German pension insurance agency and the 2007 pension insurance report.

It would be a basic contradiction of the equivalence principle if social security contributions were to be used to finance benefits constituting general government tasks and therefore not insurance-related. Employment subject to social security contributions would be burdened by a special tax without any claim to compensation. The use of general tax funds to finance non-insurance-related benefits ensures that such an exceptional burden does not arise.

According to a breakdown of the statutory pension insurance scheme, the volume of benefits not covered by (social security) contributions amounted to € 57 billion in 2003 and was therefore virtually equivalent to the figure for Federal grants (excluding contributions paid by the Federal Government to cover child-rearing periods) in the same year which totalled just under € 58 billion.[1] There is a broadly held view that non-insurance-related benefits are therefore covered.

However, such a definition of non-insurance-related benefits is not undisputed. On the one hand, for instance, the

1 See Bericht der Bundesregierung zur Entwicklung der nicht beitragsgedeckten Leistungen und der Bundesleistungen an die gesetzliche Rentenversicherung of 13 August 2004 (Federal government report on developments in benefits not covered by contributions and central government payments to the statutory pension insurance scheme) in Deutsche Rentenversicherung (German pension insurance scheme),

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migration balance - under which the general pension insurance fund makes lump-sum compensation payments to the miners' pension insurance fund (just over € 1¾ billion in 2007) - is deemed to be a non-insurance-related arrangement. A comprehensive analysis of these two fundamentally similar pension insurance sectors, however, renders this assumption highly questionable. On the other hand, there are specific calls for tax funds to be used for financing expenditure on surviving dependants' pensions (where these exceed benefits selected under the splitting option, ie the option to split pension entitlements between spouses). The justification for this is not least the fact that surviving dependants' pension provision has increasingly taken on the character of a means-tested transfer payment owing to the broader-based assessment and calculation of income (estimated volume for 2007: € 8 billion).

Pension insurance expenditure for eastern Germany is not covered by the revenues generated there, necessitating western German pension insurance schemes to step in and offset the deficit to the amount of around € 12 billion. This offsetting is sometimes construed as a non-insurance-related benefit. However, the use of tax funds to finance this deficit would fundamentally run counter to the nationally operated revenue-sharing scheme. Regional differences are not least also the result of desired migration by members of the labour force to regions where there is a high demand and, just as there are areas to be found in western Germany where deficits exist, it is quite possible that there are regions in eastern Germany where pension insurance schemes enjoy a surplus. At the very most, if the separate rules for calculating and adjusting pension levels which apply to eastern German pension insurance were to be interpreted as exceptional benefits, then non-insurance-related approaches would be justifiable in this context.[2]

On the question of benefits not covered by contributions the breakdown of the statutory pension insurance scheme excludes pension entitlements arising from child-rearing periods which have applied since 1992. At the same time, however, central government contributions made for this purpose are not listed under the Federal grant either. In actual fact, however, virtually no payments of this kind have been made so far whereas contributions totalling € 11½ billion per annum are being transferred on an ongoing basis. Since these contributions are not being put aside in the pay-as-you-go pension system, the current arrangements will result in a lower contribution rate until the earmarked expenditure moves into line with contribution payments.[3]

In future, the adjustment rules will ensure that Federal grants keep pace with pension expenditure. By contrast, a number of non-insurance-related benefits are expected to decline in importance, one example being the pension-bolstering recognition of periods of military service in World War II which will soon cease to be of significance. Furthermore, the recognition and evaluation of periods of education and training have been almost completely halted with the effect that no more pension claims can be made on this basis. Likewise, full early retirement pensions granted without deductions – a detail making them overly generous from an actuarial point of view – will no longer be relevant in the future.

All in all, it should not be forgotten that the scope of non-insurance-related benefits within the statutory pension insurance scheme is a subject of some controversy. Nevertheless, current central government payments could generally be described as generous, especially if yet-to-be-effected expenditure for child-rearing periods is taken into account. Even so, the lower returns of the pay-as-you-go system when compared with capital market returns could also be regarded as inconsistent with a strict interpretation of the principle of contribution equivalence. Seen in this light, it would be perfectly logical to regard the resulting specific implied taxation of employees subject to social security contributions as a non-insurance-related factor.

October 2004, p 579 (available in German only). — **2** See German Council of Economic Experts, Jahresgutachten 2005-06, item 554f (available in German only). — **3** See Bundestags-Drucksache 16/1614 of 29 May 2006.

gate potential output, a longer period of employment of older persons is certainly very significant.[15]

Federal grants

Federal grant to finance non-insurance-related benefits

Over the past ten years, Federal grants have been significantly extended. These can be set against expenditure by the pension insurance scheme on which there are no claims arising from contribution payments. There is broad consensus that the grants now paid are sufficient to finance the non-insurance-related benefits of the statutory pension insurance scheme. However, there is controversy about how these should be individually defined (see the overview on pages 56-57). In accordance with the insurance principle, only benefits consistent with the insurance should normally be financed by contributions. Other benefits that are perceived as desirable by society in general should, by contrast, be paid from general taxation. In this case, however, the high level of Federal grants and the tensions in the government budget should also be taken into account. A critical examination of the existing non-insurance-related benefits therefore seems appropriate.

Future contribution rate and security level targets

Longer-term projections could reduce uncertainty

The available projections of the Federal Government go as far as 2021 and do not show any conflict between the statutory targets of a maximum contribution rate of 20% and a minimum security level of 46% before taxes until 2020.[16] The 2030 targets of a maximum contribution rate of 22% together with a minimum security level of 43% also appear achievable if the measures decided are implemented consistently. However, since demographic ageing will continue to rise after 2030, these rates will not be achievable after that without further measures. According to present assumptions, it will not be until after 2040 that the lower birth rate, at least, will probably cease to put substantial pressure on the contribution rate, since, by then, not only the contribution payers but also most pensioners will have been born in the years with a lower birth rate. However, the increasing life expectancy will probably still remain a financial problem. Nevertheless, this could be solved by a continual adjustment of the statutory retirement age. All in all, a much longer-term projection of pension financing giving concrete shape to the long-term need for action and preventing excessive expectations as well as uncertainty seems appropriate for a forward-looking and long-term pension policy.

15 For example, the German Council of Economic Experts estimates a positive effect on the annual potential growth rate of 0.1 percentage point or 0.3 percentage point in the period from 2012 to 2029 owing to the higher potential labour force resulting from the raising of the statutory retirement age (Gutachten 2007/08, items 267 ff).
16 See 2007 Pension Insurance Report of the Federal Government, Bundestags-Drucksache 16/7300 of 22 November 2007.

Further aspects of the debate on pension policy

Shift of emphasis towards greater capital funding

Other forms of old-age provision likely to become more important

The most recent reforms set the parameters of the statutory pension insurance scheme in such a way that the system should remain financially stable at least until 2030. The decreasing returns that necessarily result from current demographic developments are reflected mainly in higher contribution rates and lower relative pension levels.[17] For those aiming at a higher level of financial security, these lower relative pension levels necessitate an additional – generally funded – pension. Persons who have so far had false expectations about the future benefits of the statutory pension insurance scheme are likely to re-adjust their saving efforts. All in all, owing to the decreasing benefits of the statutory pension insurance scheme, this will likely result in a shift of emphasis over time from pay-as-you-go financing to funded pensions (see also the overview on pages 60-61).

No efficiency gains to be expected solely from change in financing

Generally speaking, higher returns can be expected from funded pensions than from the pay-as-you-go system.[18] However, with an existing pay-as-you-go system whose introduction financed earlier generations of pensioners, a changeover to funded pensions by itself cannot be expected to bring about net gains in the sense that the beneficiaries of the reform compensate the losers and can still gain an advantage. Instead, it should generally be assumed that gains and losses practically offset each other.[19] Ultimately, this area also requires a decision on the intergenerational distribution, ie how burdens and benefits linked to the statutory pension insurance scheme are to be distributed among the different generations.

Extension of the group of persons subject to compulsory insurance

Extension of insurance obligation to self-employed persons ...

... for protection against poverty in old age ...

The occasional demands for an extension of the group of persons subject to compulsory insurance, particularly for the inclusion of self-employed persons, are based mainly on two lines of argument. One is that a minimum financial provision for old age which is as comprehensive as possible must be ensured. Thus, individual provisions for old age reduce poverty in old age, which would otherwise have to be financed by the community through social security benefits within the framework of minimum income security.

17 For the calculation of implied returns, see Gutachten des Sozialbeirats zum Rentenversicherungsbericht 2004 (Bundestags-Drucksache 15/4498), pp 90 ff.

18 The returns of pay-as-you-go pension schemes payable to all except the generation introducing them result from the growth rate of the wage sum, which is made up of the increase in per capita earnings and number of employees and should differ only marginally from the macroeconomic growth rate in the longer term. By contrast, the average returns of funded pensions result from the interest rates on the capital market less effects reducing returns such as high administrative costs and premium surcharges owing to an asymmetric distribution of information between insured persons and cautiously calculating insurers.

19 See Deutsche Bundesbank, Prospects for, and obstacles to, a stronger reliance on funding in the statutory system of old-age provision in Germany, Monthly Report, December 1999, p 22 as well as, for a basis of the theory, F Breyer (1989), On the Intergenerational Pareto Efficiency of Pay-as-you-go Financial Pension Systems, Journal of Institutional and Theoretical Economics (JITE), 145, pp 643-658. Models in which the changeover from pay-as-you-go to funded pensions show efficiency gains are ultimately based on the assumption that the explicit tax for financing the changeover involves smaller distortions (particularly on the labour market) than the continuation of the implicit taxation in the pay-as-you-go system.

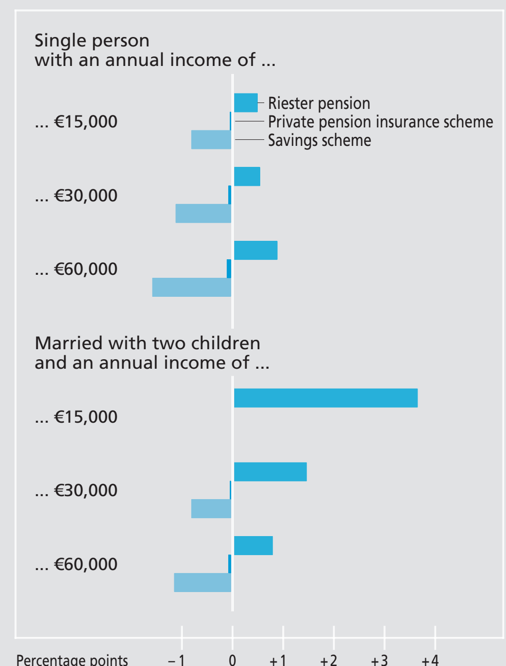
Government promotion of company and private old-age provision

In addition to the introduction of measures to dampen the contribution rate in the statutory pension insurance scheme, Parliament has considerably stepped up government promotion efforts for both company and private old-age provision. In 2002 employees became entitled to make direct payments into company pension insurance schemes. Since then up to 4% of the maximum level of earnings subject to contributions to the statutory pension insurance scheme (currently €2,544 per year) can be invested free of tax and social security contributions in a company pension insurance scheme.[1] Downstream taxation then comes into effect during the pension-drawing period, and since 2004 full contributions to the statutory health insurance scheme and the public long-term care insurance scheme also have to be made from company pensions. The original limit for exemption from social security contributions up until the end of 2008 has since been extended. According to survey results, the company pension insurance scheme has greatly expanded since 2001. The survey shows that, at the end of 2001, 38% of employees subject to social security contributions in the private sector were entitled to a company pension. By mid-2004, this figure had increased to 46%, which is probably predominantly attributable to the additional state assistance. Recent survey results do not distinguish between the private and public sector. However, they point to the fact that the expansion had lost a great deal of momentum by the end of 2006.[2]

The "Riester pension" was introduced in 2002 as an additional measure to promote private pension insurance schemes. As long as pension products fulfil statutory criteria, a certain contribution can since be offset as special expenditure against tax. The maximum pension contribution initially amounted to €525 per year. However, this maximum contribution was increased in biennial increments of the same amount and in 2008 reached the final amount of €2,100. An additional allowance was introduced to provide further support to low-paid workers and parents.[3] As a result of government promotion measures, for a given gross rate of interest, the Riester pension provides a higher net rate of return than other private pension insurance schemes (with tax-free revenue in the savings phase) or savings plans without state assistance for which both contributions and regular interest income are subject to tax. Owing to the (recently extended) additional allowance, the Riester pension provides a particularly large yield advantage, especially for low-paid workers with children.

The advantage of downstream taxation – as in the case of the Riester pension – compared to upstream tax treat-

Effect of taxation and government promotion of private old-age provision on an assumed return[4]



1 At the same time as the flat rate taxation for funded pensions ended pursuant to section 40b of the Income Tax Act, direct insurance was included in the promotion measures pursuant to section 3 number 63 of the Income Tax Act and the tax allowance was increased by €1,800 per year across the board. — **2** See TNS Infratest Sozialforschung, Situation und Entwicklung der betrieblichen Altersversorgung in Privatwirtschaft und öffentlichem Dienst 2001 – 2004, Munich, 21 September 2005, as well as TNS Infratest Sozialforschung, Situation und Entwicklung der betrieblichen Altersversorgung in Privatwirtschaft und öffentlichem Dienst 2001 – 2006, Munich, 22 June 2007. — **3** At the start, the allowance amounted to €36 per adult and an additional €46 per child. After the biennial increases, the allowances amount to €154 and €185 respectively from 2008. For children born after 31 December 2007, the allowance has been increased to €300. — **4** Assumed nominal gross rate of return: 4% per annum, savings phase: 45 years, pension-drawing period: 21 years, marginal tax rate halved in retirement. — **5** In the 2005 Alterssicherungsbericht (Bundestags-Drucksache 16/906), the Federal Government stated that the overall pension

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ment (of contributions and interest income in the savings phase) lies, on the one hand, in tax exemption for investment income and, on the other hand, in the fact that, during retirement, income and therefore the tax rate, which results from the progressive rate of tax, should be lower than during working years. While other private pension insurance schemes also provide tax-free interest income during the savings phase, they differ from the Riester pension in that there is no tax relief resulting from the progressive rate of tax by shifting taxable income to the retirement phase

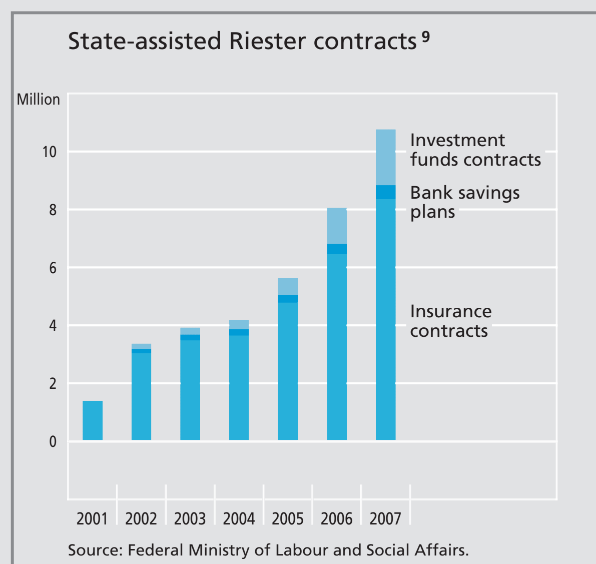
If the Riester pension is to achieve a certain net pension level during retirement, the downstream taxation has to be charged during the payout phase. If the benefit restrictions in the statutory pension insurance scheme are to be balanced out, this would generally require more than just Riester pension contributions.[5]

The number of state-assisted Riester contracts had increased rapidly to 4 million by the end of 2003. The situation then stagnated until mid-2005. It was not until after this date that a sharp and constant increase to 10¾ million contracts by the end of 2007 was recorded. Not least the simplification of the assistance criteria and the extensive reduction in the fiscal privileges of those life insurance contracts[6] concluded after 2004 are likely to have contributed to this increase. However, the overall volume of pensions as well as the macroeconomic savings were expanded only to the degree that they were not substituted by another type of pension scheme.[7]

In 2007 state assistance for the Riester pension allowances amounted to over €1 billion. A complete set of data for tax shortfalls as a result of tax allowances is available up until 2003 (€54 million) only. However, these are likely to amount to approximately two-thirds of total allowances.[8] As the last increment is due in 2008 and the number of contracts has recently grown rather dynamically, costs are likely to soar. If savings are not made elsewhere, this will lead to an even greater level of government debt or an immediate larger tax burden. A higher debt level would mean that additional charges are postponed until a future date. Increased taxation would not only make private pension investment more difficult but would also cause other distortions.

Overall, government promotion of company and private pension insurance schemes comprises a wide and, owing to numerous special regulations, complex range of tools. Increased transparency and further simplifications of assistance criteria could contribute to a greater understanding of pension products. There is also a need for comprehensive statistics, in particular for the company pension insurance scheme. In conclusion, it is key, as with every state subsidy, to ensure a specific and transparent allocation to enable an efficient use of funds and regular performance monitoring.

State-assisted Riester contracts[9]



Source: Federal Ministry of Labour and Social Affairs.

level would remain broadly constant and, in the long term, even rise only if tax savings from the gradual tax exemption of contributions to the statutory pension insurance scheme were invested in an additional private pension insurance scheme. — **6** Life insurance contracts concluded up until 31 December 2004 can be paid out tax free after a term of 12 years. Interest income, too, therefore remains unaffected by taxation during the savings phase. For newer contracts, in such cases, tax is charged on half of the amount to be paid out (section 20 (1) number 6 of the Income Tax Act). — **7** Compared to the annual average for 2000 to 2003 of just over 2 million new endowment policies (including unit-linked insurance policies), only around 1¼ million new contracts were concluded in both 2005 and 2006. However, 1½ million new Riester contracts were concluded in 2005 and 2½ million in 2006. — **8** See Bundestags-Drucksache 16/8016. — **9** Excluding contracts for company pension insurance schemes.

In this way, strategic behaviour at the expense of all tax payers is reduced. But this means that compulsory private pension schemes might also be an option.

... and for more equal taxation

The other argument is that the existing pay-as-you-go system generally results in a less favourable return on contributions than a private system. In the interests of more equal taxation, the resulting implied tax should become more broadly based through a more comprehensive pension insurance obligation. Alternatively, compensation for the poorer return obtained by persons in the statutory pension insurance scheme might be a consideration. This would be financed from general tax resources and would therefore also involve the group of non-insured persons. In this way, the pension contribution could be reduced to such an extent that a certain remuneration would be reached in the statutory pension insurance scheme, comparable to the returns expected from funded pensions, although one would have to expect major difficulties in determining the targeted rate of return. In this case, the implied group-specific taxation would be replaced by a general explicit taxation. Persons insured in the statutory scheme would be among those bearing the higher explicit tax burden. On balance, however, only those previously not subject to the insurance obligation and therefore exempt from the implied tax would receive an additional burden.

Distribution effects depend on exact structure

In general, the distribution issue must first be resolved, and that is also the case here. If additional contribution payers are included in the statutory pension insurance scheme, the scheme's financial situation improves temporarily, because the new contributions are not paid out until a later stage. How this relief is actually distributed among the persons involved depends on the degree to which the higher inpayments (which, in the long term, are also offset by pension claims of the new insured persons) are added to reserves or used for reducing contributions or even extending benefits.

Measures to prevent increasing poverty in old age

Fear of increasing poverty in old age

As a consequence of the falling (relative) pension level, it is feared that poverty in old age might become a significant problem in the future. At the end of 2006, 2.3% of those aged 65 and over received benefits within the framework of the needs-based basic allowance for elderly persons. In comparison, just over 10% of the population aged under 65 received benefits within the framework of the basic allowance for job seekers. In future, the percentage for elderly persons could rise in view of increasing interrupted work histories and therefore lower pension entitlements. The declining pension level has an effect on poverty in old age, if this causes the pensions to increase at a slower rate than the basic allowances and this is not accompanied by any compensating private pension.[20] Against this background, there are calls for entrusting the statutory pension insurance scheme with the

20 Like the pensions, the basic allowances are generally adjusted annually on 1 July. In addition, there is always a general review of the standard rate when new data from the income and expenditure survey become available (section 28 (3) of the Seventh Book of the Social Security Code).

task of providing for an explicit minimum income guarantee.

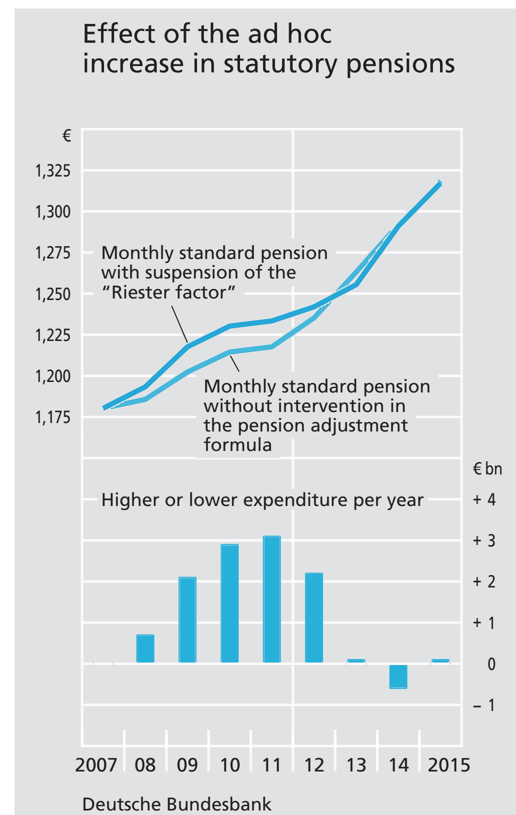
Basic allowance for elderly persons and people with reduced earning capacity aims at preventing poverty

In Germany, the state guarantees an income amounting to the socio-cultural minimum subsistence level and therefore aims at providing sufficient social benefits to prevent poverty. This individual security measure therefore presupposes a poverty line. As a general government task, it is financed from general tax funds, in line with regulatory policy. If such benefits for elderly persons were relocated to the pension insurance scheme, they would have to be classified as non-insurance-related and financed from tax funds, in line with the system. If social benefits exceeding the poverty line are to be introduced particularly for elderly persons, it must be remembered that this would involve financial burdens entailing a further transfer from the younger to the older generations.

Ad hoc increase in pension adjustment in 2008 and 2009

Greater pension adjustment causes heavy burdens

The increases in presumed contributions to supplementary private pension schemes agreed in the 2001 pension reform are to effect an overall 5% downward adjustment of pensions between 2003 and 2010. So far, however, only four of eight steps have been put into practice, two of which – in 2005 and 2006 – have not yet had an effect owing to a safeguard clause. This means, in effect, that pension adjustments have so far been made only in 2003 and 2007, reducing pensions by just over 0.6 percentage point in each case. It is now planned to defer the measure in 2008 and 2009 by an ad hoc intervention in the



general adjustment mechanism and make up for it in 2012 and 2013. This will enable pensions to be raised by 1.1% this year. Next year, the adjustment could rise above 2% if average wages and salaries in 2008 increase by 2½%, as expected by the Federal Government. The discretionary intervention will entail additional expenditure of almost €¾ billion for the pension insurance scheme in the current year , and this will rise to just over €2 billion in 2009 and €3 billion in 2010. In total, additional expenditure of around €12 billion is to be expected.

Greater pension adjustment virtually credit-financed

Owing to the present relatively favourable financial situation of the statutory pension insurance scheme, the higher pensions can be initially financed from the reserves. Only if the deferred moderation steps are subse-

quently carried out, does a temporary additional burden remain, which will ultimately have to be financed in the coming years through higher contribution rates (and also by tax payers through the Federal grant that is linked to the contribution rate). This increases the already heavy burden placed on younger generations.

Consistently higher contribution rate if downward adjustment does not occur

From 2011, the omission of the pension reductions in 2005 and 2006 is to be made good by halving the adjustment rates. At that time, there would be a cumulation of dampening effects and thus particularly low annual pension increases. Moreover, a further deferral of the downward adjustment will become more and more difficult, because it would affect years which are increasingly marked by the demographic ageing process and in which the sustainability factor will have an increasingly reducing effect on the adjustment. This does not facilitate the political enforceability, particularly if the assumed continuously high wage increases turn out to be lower than in the projections. If it is not possible to make the deferred reduction steps later, there is the danger of a constantly 0.3 percentage point higher contribution rate and thus an overshooting of the maximum contribution rate.

Concluding remarks

Reliable pension policy requires long-term projections

The statutory pension insurance scheme is strongly influenced by demographic developments. Awareness of this has grown significantly over the past few years. Long-term projections, in particular, have made it clear that significant changes in the central parameters for the financial development are necessary in order to stabilise the system on a permanent basis. A transparent and logical presentation of long-term developments and the expected changes in contribution rates, retirement age and pension level can create confidence and planning security with regard to individual old-age provisions. This is necessary not least to adjust consumption and saving decisions early enough to achieve the desired level of financial security in old age.

Burden distribution until 2030 announced so far

With the reforms of the past few years, most of the adjustment measures necessary until 2030 have been announced. The measures decided ensure the sustainability of the pension insurance scheme until then and will significantly influence the individual parameters. Accordingly, there will be a future rise in the contribution rate, although this is to be limited, particularly by lowering the relative pension level and increasing the statutory retirement age. Ultimately, however, the fact remains that younger generations will have to bear significant burdens. Overall, the importance of private pensions will increase.

Adherence to agreed reforms essential for longer-term confidence

However, the confidence, particularly of younger generations, in the development projected for the medium to long term and ultimately in the statutory pension insurance scheme depends essentially on the agreed paths actually being followed. For example, if the temporarily positive financial situation now foreseeable is used as an occasion for ad hoc improvements in benefits for current pensioners who have relatively high pension

levels, new burdens – similar to borrowing – will be postponed until the future.

Further adjustments appropriate, particularly for retirement age

It is already foreseeable that life expectancy will continue to rise beyond 2030. Therefore, further adjustments will be necessary in future. In this case, it is important to arrive at a consensus regarding the future development of the pension insurance scheme and to create planning security in good time. Especially in view of the rising life expectancy, a further adjustment to the statutory retirement age seems reasonable, since otherwise the ratio of the retirement phase to the years worked would continually increase. This would automatically increase the financial burden an the pension insurance, and the sustainability of the pension system would be put at risk.

Strengthening of economic power facilitates handling of demographic changes

From a macroeconomic perspective, the handling of demographic changes is facilitated by stronger growth in potential output. A further reduction in structural unemployment and increased participation in the labour force, particularly of older persons, will be contributory factors here. An attractive environment for employees as well as for investment is ultimately the basis for social welfare and sustainable pension and public finances.

Annex

Important new legislation concerning the financing of old-age provision since 1997

Pension Reform Act 1999 *(Rentenreformgesetz 1999)* (16 December 1997)

– This Act laid down that a demographic factor was to be integrated into the pension adjustment formula. If the further life expectancy of people aged 65 were to rise, pension increases were to be lower. The demographic factor could not lead to a pension cut, however. A minimum of 64% was envisaged for the net standard pension level.

– In order to stabilise the development of the contribution rate, a pinpoint target of exactly 1 month of expenditure was no longer to be defined for the reserve at the end of the following year but rather a target corridor of 1 to 1½ months of expenditure. The contribution rate would have to be adjusted only if there were a danger of this corridor being breached.

– It was laid down that child-rearing periods would be revalued from 75% of the average income to 100% as of 1 July 2000. Furthermore, there was to be no offsetting against other income (“additive” consideration).

– The Act stipulated that the occupational disability pension and the general disability pension would be amalgamated into the pension for reduced earning capacity. The intention was that the labour market risk should no longer place a strain on the statutory pension insurance scheme, ie the granting of a pension for reduced earning capacity would depend solely on the objective state of health and no longer on *de facto*

employment opportunities (transition from a concrete to an abstract approach).

– If the pension for reduced earning capacity were to commence after the age of 60, benefits would be deducted in the amount of 3.6% per year in relation to the age of 63, ie up to a maximum of 10.8%. At the same time, the reckonable time between the ages of 55 and 60 was to be given a weighting of two-thirds of the claimant's average earnings (previously one-third). The retirement age for severely disabled persons was to be raised from 60 to 63.

– An additional Federal grant was to be introduced as of 1 April 1998, which was to correspond continuously to the volume of revenue generated by 1 percentage point of the standard rate of VAT.

Act Concerning the Financing of an Additional Federal Grant for the Statutory Pension Insurance Scheme *(Gesetz zur Finanzierung eines zusätzlichen Bundeszuschusses zur gesetzlichen Rentenversicherung)* (19 December 1997)

The standard rate of VAT was raised from 15% to 16% to finance the additional Federal grant in order to prevent an otherwise impending increase in the contribution rate to more than 20.3%.

Act on Adjustments in the Social Security Scheme and the Safeguarding of Employee Rights *(Gesetz zu Korrekturen in der Sozialversicherung und zur Sicherung der Arbeitnehmerrechte)* (19 December 1998)

– The application of provisions in the Pension Reform Act 1999 was suspended: those relating to the demographic factor were not applicable in the years 1999 and 2000 while the new legislation concerning the occupational disability pension and the general disability pension was not applicable in 2000.

– This Act laid down that central government would pay contributions to cover periods of child-rearing and refund costs associated with German reunification. At the same time, the general Federal grant was cut by a (marginal) amount. All in all, it was therefore possible to lower the contribution rate from 20.3% to 19.5% on 1 April 1999.

Act Revising the Arrangements for Low-Paid Part-Time Workers *(Gesetz zur Neuregelung der geringfügigen Beschäftigungsverhältnisse)* (24 March 1999)

The income limit for low-paid part-time employment was uniformly set at DM630 per month. In order to counter an erosion of the contribution base, 10% as a rule was to be paid into the statutory health insurance scheme and 12% into the statutory pension insurance scheme rather than this income being subject to a flat-rate tax of 20% (plus the solidarity surcharge and, if applicable, church tax). Employees could voluntarily increase their pension contributions to the normal contribution rate in order to enlarge their pension entitlement and also gain access to all insurance benefits.

Act to Promote Self-Employment *(Gesetz zur Förderung der Selbständigkeit)* (20 December 1999)

In order to limit the evasion of social security contributions through "pseudo self-employment", this Act clearly set out the relevant criteria and placed

the onus of proof on potential social security contributors.

Budget Consolidation Act 1999 *(Haushaltssanierungsgesetz 1999)* (22 December 1999)

– The additional Federal grant was increased by means of a component financed from ecology tax starting in the year 2000. For subsequent years, the increases were laid down by law and, from 2004 onwards, the new grant was to be continued on the basis of the revenue generated by central government from ecology tax. Correspondingly, the part of the additional Federal grant financed from VAT was to be cut by a discretionary amount in the years 2001 to 2003.

– In derogation of the pension adjustment formula, it was laid down that pensions would be raised in line with the previous year's inflation rate in 2000 and 2001.

– The pension insurance contribution rate for the year 2000 was set at 19.3% by law.

– From 1 January 2000 onwards, the contributions to the statutory pension insurance scheme for recipients of unemployment assistance were no longer to be based on 80% of their previous gross earnings but rather on the amount of unemployment assistance actually paid.

Act to Reform the Pension for Reduced Earning Capacity *(Gesetz zur Reform der Renten wegen verminderter Erwerbsfähigkeit)* (20 December 2000)

– Upon coming into force, this Act abolished the occupational disability pension for persons below the age of 40.

– The general disability pension was replaced by a two-stage pension for reduced earning capacity. Labour market opportunities would be taken into consideration in the case of persons with only partially reduced earning capacity ("concrete approach"). For the duration of the recipient's entitlement to unemployment benefit, the Federal Labour Office would refund half of the pension for reduced earning capacity.

– If a pension for reduced earning capacity were to commence after the age of 60, benefits would be deducted in the amount of 3.6% per year in relation to the age of 63, ie up to a maximum of 10.8%. At the same time, the reckonable time between the ages of 55 and 60 would be taken into account at 100% of the claimant's average earnings (rather than previously one-third).

– It was stipulated that, after 2003, the additional Federal grant financed from ecology tax would no longer be continued on the basis of the revenue generated from ecology tax but rather at the rate of growth in total gross wages and salaries.

Supplementary Act Promoting Private Pension Plans *(Altersvermögensergänzungsgesetz)* (21 March 2001)

– This Act involved a changeover from net wage adjustment to modified gross wage adjustment. It was laid down that taxation and the burden of other social security contributions would no longer play a role in respect of pension adjustments. Owing to supplementary provisions for old age ("Riester reform steps"), pensions would grow more slowly over a period of eight years to the equivalent extent that increasing contributions were assumed to be made to private pen-

sion schemes (overall adjustment-reducing effect: just over 0.6 percentage point per year).

– Target contribution rates were set by law for the first time: the pension contribution rate should not exceed 20% before 2020 and 22% before 2030. If these limits should be exceeded before the relevant deadlines, the Federal Government would have to propose countermeasures. At the same time, it was laid down that the net standard pension level in the respective 15-year projections must not fall below 64%.

– The Act also envisaged a reform of the legislation pertaining to surviving dependants: the "widow's pension payable at the high rate" was to be reduced from 60% to 55% of the deceased spouse's basic statutory pension. However, an additional pension point was granted for each child reared. As of 2002, virtually all other income would be taken into account, the main exception being "Riester" private pension provisions. The tax allowances for own income were to be frozen. The option to split pension entitlements was introduced as a voluntary alternative to the previous surviving dependants' pension.

– The Act laid down that periods spent caring for a child up to the age of 10 would count towards a pension entitlement if a job was taken up.

Act Promoting Private Pension Plans *(Altersvermögensgesetz)* (26 June 2001)

– This Act laid down the government assistance available for private pension provision (in the form of "Riester" private pensions) and company pension schemes (in particular, the right to make direct payments into a scheme that are tax-free and – up to the end of 2008 – not subject to social security contributions).

– Annual information on pensions was introduced for the statutory pension insurance scheme.

– The basic allowance for elderly persons and for people with reduced earning capacity was introduced as a special form of social assistance. It was laid down that children would no longer be legally obliged to support their elderly parents unless their income exceeded €100,000 per year.

Act to Improve the Legislation Pertaining to Surviving Dependants' Pensions *(Gesetz zur Verbesserung des Hinterbliebenenrentenrechts)* (17 July 2001)

– This Act revoked the freezing of the tax allowances for income taken into account within the framework of the surviving dependants' pension as previously laid down in the Supplementary Act Promoting Private Pension Plans.

– The surviving dependants' pension would now be raised by two pension points for the first child. One extra pension point would still be granted for every further child.

Act to Determine the Fluctuation Reserve in the Workers' and Salaried Employees' Pension Insurance Schemes *(Gesetz zur Bestimmung der Schwankungsreserve in der Rentenversicherung der Arbeiter und der Angestellten)* (20 December 2001)

– The minimum reserve requirement was reduced from 1.0 to 0.8 of monthly expenditure.

– The contribution rate for 2002 was set at 19.1% by law.

Act to Stabilise Contribution Rates *(Beitragssatzsicherungsgesetz)* (23 December 2002)

– The minimum reserve requirement was reduced from 0.8 to 0.5 of monthly expenditure.

– Under this Act, there was an extraordinary increase in the maximum level of earnings subject to contributions from €4,500 (western Germany) and €3,750 (eastern Germany) to €5,100 and €4,250 per month, respectively.

– The contribution rate for 2003 was set at 19.5% by law.

Second Act Promoting Modern Labour Market Services *(Zweites Gesetz für moderne Dienstleistungen am Arbeitsmarkt)* (23 December 2002)

This Act revised the arrangements for low-paid part-time workers ("mini-jobs") introducing a uniform monthly earnings ceiling of €400. It also introduced "midi-jobs" with a sliding wage scale between €400 and €800 per month in which the tax and social security burden gradually increases to a normal level.

Second Act Amending the Sixth Book of the Social Security Code *(Zweites SGB VI-Änderungsgesetz)* (27 December 2003)

– The minimum reserve requirement was reduced from 0.5 to 0.2 of monthly expenditure.

– This Act laid down that, from 1 April 2004 onwards, the statutory pension insurance scheme would no longer pay part of the pensioners' contribution to the long-term care insurance scheme. Pensioners would then have to pay this contribution totally by themselves.

– It was stipulated that changes in statutory health insurance schemes' contribution rates would be passed on to pensioners more quickly.

– The pension adjustment scheduled for 1 July 2004 was deferred.

Third Act Amending the Sixth Book of the Social Security Code *(Drittes SGB VI-Änderungsgesetz)* (27 December 2003)

This Act laid down that, from 1 April 2004 onwards, new pensions would be paid out in arrears at the end of each month.

Retirement Income Act *(Alterseinkünftegesetz)* (5 July 2004)

– This Act implemented a gradual changeover to a downstream taxation of pensions. It was laid down that the taxable part of a pension would increase in steps of 2 percentage points from 50% for existing pensioners and those receiving a pension for the first time in 2005 to 80% in 2020. Thereafter, it would increase by 1 percentage point per year to 100% for new pension recipients from 2040 onwards. At the same time, it was stipulated that the share of tax-free pension contributions would be raised from the 2005 level of 60% by 2 percentage points per year up to the year 2025.

– The provisions for a "Rürup" pension plan would involve the same taxation principles for cases in which – analogously to the statutory

pension insurance scheme – a life annuity is to be provided, which may not begin before the recipient reaches the age of 60 and cannot be bequeathed, transferred, used as collateral, sold or capitalised.

- The tax imposed on the income share of private pension insurance contracts taxed upstream was lowered.

- In the area of company pension schemes, the flat-rate taxation option pursuant to section 40b of the Income Tax Act (*Einkommensteuergesetz*) was abolished. Instead, the upper limits for direct payments into a scheme that are tax-free and not subject to social security contributions were raised by €1,800 per year.

- A constraint was introduced for the tax advantage on life insurance contracts concluded from 2005 onwards. It was stipulated that, in future, half of the difference between the contributions paid and the amount paid out would be subject to taxation.

- Simplifications and the obligation to use unisex tariffs for "Riester" private pensions were implemented.

Pension Insurance Sustainability Act *(RV-Nachhaltigkeitsgesetz)* (21 July 2004)

- A sustainability factor was integrated into the pension adjustment formula: if the ratio of (equivalent) pensioners to (equivalent) contributors were to rise, this would result in a lower pension increase. A safeguard clause was incorporated to prevent a cut in the pension payment amount owing to the moderating factors within the adjustment formula. A reduction is possible only if there is also a fall in average wages and salaries.

- It was laid down that pension adjustments would be oriented more closely to growth in actual wages and salaries subject to compulsory contributions.

- The Act introduced a progressive increase up to the end of 2008 in the statutory retirement age from 60 to 63 years in the event of unemployment or following a period of phased retirement.

- Non-contributory pension points for periods spent in school or university education were almost totally abolished. Only a few exceptions were to remain: periods of vocational training, periods spent in education at technical colleges and periods spent participating in preparatory vocational activities.

- As it was no longer possible to identify a general net standard pension level owing to the gradual changeover to downstream taxation, the level safeguard targets were redefined. It was laid down that, in future, the guaranteed level before tax (standard pension in relation to average earnings, in each case after deduction of social security contributions but before income tax) should not fall below 46% up to or before 2020 and 43% up to or before 2030.

Act on the Organisational Reform of the Statutory Pension Insurance Scheme *(Gesetz zur Organisationsreform in der gesetzlichen Rentenversicherung)* (9 December 2004)

- Under this Act, the workers' pension insurance scheme and the salaried employees' pension in-

surance scheme were amalgamated into a general pension insurance scheme, the German Pension Insurance ("Deutsche Rentenversicherung").

– The miners' federal pension insurance scheme, the railway workers' insurance institution and the seamen's pension insurance scheme were amalgamated into the German Pension Insurance for Miners, Railway and Maritime Workers ("Deutsche Rentenversicherung Knappschaft-Bahn-See").

Act to Adjust the Financing of Tooth Replacement *(Gesetz zur Anpassung der Finanzierung von Zahnersatz)* (15 December 2004)

It was laid down that, from 1 July 2005 onwards, members of statutory health insurance schemes would pay a special contribution of 0.9% of their income subject to compulsory contributions. The pensioners' contribution rate for health insurance to be financed at par would be reduced in equal proportion.

Act Amending the Fourth and Sixth Books of the Social Security Code *(Gesetz zur Änderung des Vierten und Sechsten Buches Sozialgesetzbuch)* (3 August 2005)

This Act laid down that, in future, social security contributions, which are determined according to the pay received at the end of the month, would no longer be payable by the 15th day of the following month but, instead, no later than the third last working day of the month in question. The draft Act estimated that an additional 0.8 month's worth of compulsory contributions would be received in the year 2006.

Act Amending the Second Book of the Social Security Code and Other Acts *(Gesetz zur Änderung des Zweiten Buches Sozialgesetzbuch und anderer Gesetze)* (24 March 2006)

The standard assessment base for pension contributions for recipients of unemployment benefit II was almost halved, falling from €400 to €205 per month.

Act on the Continued Validity of the Current Pension Levels as of 1 July 2006 *(Gesetz über die Weitergeltung der aktuellen Rentenwerte ab 1. Juli 2006)* (15 June 2006)

In order to rule out a potential pension cut, a waiver of the pension adjustment scheduled for 1 July 2006 was laid down by law.

Act Accompanying the 2006 Budget *(Haushaltsbegleitgesetz 2006)* (29 June 2006)

– Under this Act, the pension contribution rate for "mini-jobs" was raised from 12% to 15% on 1 July 2006.

– This was accompanied by an offsetting cut in the general Federal grant of €170 million in 2006 and €340 million in each of the subsequent years.

Act Adjusting the Retirement Age under the Statutory Pension Insurance Scheme *(RV-Altersgrenzenanpassungsgesetz)* (20 April 2007)

– This Act laid down a gradual increase in the statutory retirement age from 65 to 67 years from 2012 to 2029.

– An exception would apply to insured persons who had paid compulsory contributions for a particularly long period of time (at least 45 years). They would still be able to retire on a pension without deductions at the age of 65.

– The safeguard clause was modified to the extent that, from 2011 onwards, deferred pension cuts have to be offset against positive pension adjustments so as to be able to achieve long-term target contribution rates.

Act Promoting Additional Old-Age Provision and Amending the Third Book of the Social Security Code *(Gesetz zur Förderung der zusätzlichen Altersvorsorge und zur Änderung des Dritten Buches Sozialgesetzbuch)* (10 December 2007)

– This Act removed the time limit – originally up to the end of 2008 – until which direct payments made into company pension schemes would be exempt from social security contributions.

– The vesting age for an employer-financed company pension entitlement was lowered from 30 to 25 years.