CURRENT CHALLENGES OF THE GERMAN SOCIAL SECURITY SYSTEM

BY **NATALIA LÖFFLAD**

In the Social Security Working Group of the German Association of Actuaries (DAV), dedicated DAV members examine legislative projects from a professional and actuarial perspective. The following remarks are based on the presentation by Katja Jucht and Andreas Holle from the Social Security Working Group as part of the Continuous Professional Development series 'DAV vor Ort' (DAV on site).

NATALIA LÖFFLAD

OLD-AGE PROVISION IN GERMANY

Retirement provision in Germany is based on three pillars: The first pillar includes the State Pension (Deutsche Rentenversicherung). This system is based on a pay-as-you-go method, in which the contributions of the employed are directly used for the pension payments of current retirees. It provides a pension which is mainly based on the earned income during employment and ensures that retirees receive the financial means to maintain their standard of living in retirement.

The second pillar of retirement provision includes occupational pension schemes. Here, companies offer their employees the opportunity to build up additional pension entitlements. Occupational pension schemes are a voluntary supplement to the state pension and aim to close the retirement >

income gap. Employees can improve their retirement provision through salary conversion and/or employer contributions.

The third pillar of retirement provision is private pension schemes. This includes private pensions and endowment insurances. Private pension schemes offer flexibility and allow individuals to consider their individual needs and goals.

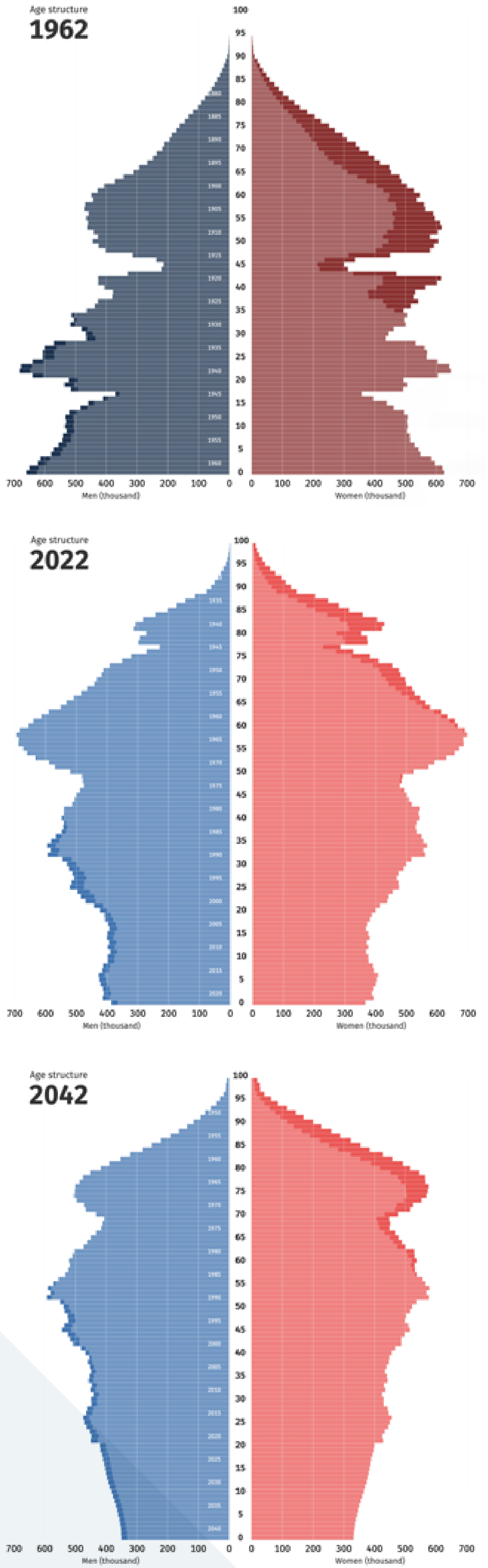
CHALLENGES OF DEMOGRAPHIC DEVELOPMENT

The increasing life expectancy and low birth rate lead to an aging population and pose a challenge for the financing of the State Pension. In 1962, the ratio of pension recipients to contributors was 1:6, while in 2020 it was already at 1:1.8, and it is expected to further decrease. A decreasing number of workers have to support a growing number of retirees. As a result, the contributions paid in 2022 were already insufficient to finance pension payments, leading to the federal government providing 21% of the statutory pension payments through subsidies of more than 100 billion euros per year.

Currently, a double safeguard mechanism is planned in the State Pension, which aims to maintain an average pension level of 48% of the average income for long-term contributing individuals, while keeping contributions below 20% of employee income (half of the contribution is paid by the employer). Both measures will further increase the federal subsidies in the future.

To meet this challenge, various measures are being discussed, such as raising the retirement age. To finance the double safeguard mechanism, the retirement age would have to be raised to 69 by 2030 and to 71 by 2045. Just fixing the average pension level at 48% already means a significant increase in the contribution rate. >

FIGURE 1: POPULATION PYRAMID SHOWING THE AGE STRUCTURE OF THE POPULATION IN GERMANY



Source: destatis.de

CURRENT POLITICAL PROJECTS

In the current legislative period, the government has planned three pension packages. Part of the first pension package, which has already been passed, includes pension increases as of July 1, 2022 (5.35% in the west and 6.12% in the east of Germany), the reintroduction of the catch-up factor, and significant improvements in existing disability pensions.

The so-called catch-up factor existed until 2018 and resulted in halving of pension adjustments for existing equalization needs (Social Insurance Pensions Improvement and Stabilization Act). This regulation was suspended in 2018 and is now intended to be reintroduced but supplemented by a 'priority rule' for the safeguard level of minimum security.
The second pension package in winter 2022 is intended to fix the minimum average pension level at 48% of the average salary for long-term contributing individuals. The costs of the State Pension are intended to be partially financed through the newly established so-called 'stock market pension (Aktienrente)', which is also part of the second pension package.

According to the coalition agreement, the introduction of capital funding will be financed by means from the federal budget amounting to 10 billion euros for the first time. In the statutory pension system, this amount would be annually lacking to finance the ongoing pension payments – additional federal subsidy will be necessary. This means that the government will assume part of the costs for the introduction of capital funding in order to facilitate the start. However, the exact financing and design of the capital funding has not yet been clarified.

The third pension package is planned for next year and will regulate retirement provision for new self-employed individuals, as agreed in the coalition agreement. Another goal of the federal government is to strengthen private pension, particularly the so-called Riester pension. It was introduced in 2002 as a funded pension system, when the net pension level was reduced after a pension reform. The Riester pension includes voluntary additional private retirement provision for employees. It is financed from net income and is supported by government allowances and special expense deductions. It aims to compensate for the decline in the pension level resulting from demographic developments.

To make retirement provision future-proof and prevent a dramatic increase in individual parameters (such as retirement age or individual contributions) of the State Pension, an intelligent mix of the available levers in the pay-as-you-go pension insurance is necessary. For example, in combination with promoting the employment of older people and strengthening occupational and private retirement provision.

ON THE WORKING GROUP

In addition to these statutory topics, the DAV working group deals with other current issues that could have an impact on the State Pension and how the problems can be better addressed. For example, it examines whether the climate ruling of the Federal Constitutional Court can be applied to the situation in the State Pension.

Further projects of the working group include the development of an intergenerational equity index for Germany, in analogy to the Australian index, where a generational report has already been written. This report examines the long-term sustainability of current policies and how demographic, technological, environmental, and other structural trends could affect the economy and the budget over the next 40 years. <

NATALIA LÖFFLAD is a board member of two IORPs (Allianz Versorgungskasse VVaG and Allianz Pensionsverein e.V). She is an actuary and fully qualified member of the German Association of Actuaries (DAV), where she recently took over the lead of the Social Security working group.