Eurofound 40 1975-2015
European Foundation for the Improvement of Living and Working Conditions

Germany: New retirement package

Published on: 09 April 2015

About

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New rules reversing reforms of Germany's statutory pension system took effect on 1 July 2014. Some critics estimate that these more generous pension rules will cost an extra € 10 billion over the next decade, and younger workers will have to fund them with little chance of receiving equally generous benefits when they retire.

On 1 July 2014, a new law reforming the German statutory pension insurance scheme took effect. The reform was presented by the parties that later became grand coalition partners, the Christian and Social Democrats, during the run-up to the federal election in autumn 2013. On 29 January 2014, the new federal cabinet presented a draft proposal which was passed by the lower and upper houses of the German parliament, the Bundestag and Bundesrat, in the first half of 2014.

New retirement package

The new retirement package has four elements (in German).

Retirement at age 63

Employees can now retire at 63 with their full state pension if they have worked for 45 years. This privilege is only accorded to those born before 1 January 1953 and receiving their pension for the first time on or after 1 July 2014. For every year that retirees were born after 1952, the threshold for claiming the same benefit rises by two months. Before the reform, statutory pension benefits were reduced by 0.3% for every month the recipient retired before the statutory retirement age. The government estimates that the additional annual costs for this measure will rise from around €1 billion in 2014 to around €3 billion in 2030.

Mothers' pension

The mothers (or, in some cases, fathers) of children born before 1992 are to receive higher pension benefits. For every child they have, their benefits will rise annually by around €343 in western Germany and around €317 in eastern Germany. The government estimated that around 9.5 million women (and a few men) would benefit from this scheme in 2014 alone. The government states that the annual costs for this measure will rise from around €3 billion in 2014 to around €6 billion in 2030.

Pensions for those with reduced earning capacity

This benefit is paid to those who are wholly or partially unable to work and earn their own living due to, for instance, illness or accident. The benefit is paid until the beneficiary reaches the statutory retirement age and qualifies for an old-age pension. Pension levels will be calculated differently for pensions first granted after 1 July 2014. For example, for someone unable to work because of illness or an occupational accident, their state pension was formerly calculated as if the beneficiary had worked up to age 60. This figure has now been raised to age 62. In addition, no deduction will be made from the final pension on the basis of earnings during the recipient's final four years of work before retirement if it can be shown that the recipient's earnings during this period were adversely affected by their poor health or physical condition.

Rehabilitation

Statutory pension insurers will receive higher budgets for rehabilitation measures. For 2014, an additional €100 million will be made available. This sum will be increased gradually to €233 million by 2017.

The new retirement package is widely considered to be the most far-reaching reform since the 1950s and its impact is being judged against the background of demographic change and the financial stability of the German statutory pension scheme.

A step forward or backward?

The latest developments need to be seen in the context of the argument put forward for major pension reform (in German) in Germany during the past decade. In 2007, the statutory retirement age was raised from 65 to 67 years. The higher limit was introduced to keep statutory pension scheme contributions, which stood at 18.9% of monthly income in 2014, in check. Contributions are capped at no more than 20% up to 2020 and no more than 22% up to 2030. At the same time, the intention is that pension levels should not drop below 46% of the average net wage up to 2020, or below 43% up to 2030. With fewer children being born and pensioners living longer, the financial basis of the German statutory pension scheme needs to be secured for future generations.

Set against this background, the latest retirement package stirred a heated debate between the social partners and economic experts.

The German Confederation of Employers' Associations (BDA) pointed out in a statement issued on 29 April 2014 that the package was the most expensive in the history of the statutory pension scheme. It would place an unfair burden on later generations (in German, 253 KB PDF) who would have to pay for current pensioners' benefits without any chance of receiving the same benefits themselves. BDA said it feared that the 22% cap on contributions up to 2030 might be breached. Measures such as making retirement possible on a full state pension for some 63 year-olds would not offer incentives to work longer or help secure enough skilled employees for the future. BDA also said the mothers' pension, being a non-insurance-related benefit, should be financed from taxes and not from public pension funds. Referring to its established position on the need to actively encourage the employment of older workers (in German), BDA said that the statutory pension scheme would only be securely financed when the number of years an individual is expected to work before qualifying for a pension is adjusted to reflect life expectancy.

In contrast, the German Confederation of Trade Unions (DGB) welcomed the new package saying that improvements to benefits paid by the statutory retirement scheme were long overdue (in German). This should only be the first of many such improvements as the statutory pension scheme needs to be financially secured for younger generations, and DGB agreed that the mothers' pension should be paid from taxes because otherwise the reserves of the public pension scheme would be used up within a couple of years. DGB proposed the creation of a 'demography reserve' by introducing higher contributions during the current legislative period, rather than waiting until after the next federal election in 2017. The additional money could be saved to finance later generations' pensions.

Finally, the German Council of Economic Experts concluded that there is no 'economic justification' for the package and so it burdens future generations unnecessarily. In its 2014/2015 Annual Report, the council said that package would involve considerable additional expenditure of around €10 billion between 2015 and 2025 (in German, 3.6 MB PDF) and make it even harder to consolidate public finances in the long run. In the view of the council, this can only be achieved with a higher statutory retirement age, low unemployment and attractive immigration options.