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Federal Republic of Germany

National Strategy Report on Old-Age Pension Provision

(NSR)

Contents

PREFACE

Applying the open method of coordination to old-age pension provision

Meeting in Gothenburg in June 2001, the European Council identified the ageing population as a major challenge in the European Union. The European Council noted a need for "a comprehensive plan to meet the challenges posed by an ageing society."[1]

For this purpose, the European Council decided, at its Stockholm meeting, to use the "open method of coordination" in old-age pension provision. Meeting in Laeken, the European Council finalised this decision and set 11 joint goals and working methods for further co-operation. The bases of this cooperation are "national strategy reports" (NSRs), which present Member States' strategies for reforming their old-age pension schemes. The 15 national strategic reports are being jointly evaluated by the European Commission and the Council. This evaluation will be submitted to the European Council at its spring 2003 meeting. Council and Commission will assess the joint goals and working methods by the end of 2004, and decide on the goals, methods and timetable of continued cooperation.

The NSR: an important step in European cooperation

By submitting the first national strategy reports, Member States are intensifying their co-operation at European level in the field of old-age pension provision. A comprehensive exchange of information and experience between Member States, covering both social and financial policy aspects of demographic trends, may be useful to Member States in their efforts at national reform. It should be emphasised, however, that the old-age pension schemes in the individual countries are the product of historical growth, and their structures therefore differ widely. There is no superhighway to modernisation of old-age pension provision which could be applied uniformly to all Member States. Each country must decide for itself which reform best suits to its own old-age pension insurance system. The open method of coordination offers a framework of cooperation between Member States at European level, which enables them to work together more closely. The method must be applied on the principle of subsidiarity. There must be no pressure for harmonisation, nor shift of responsibilities. Responsibility for old-age pension provision must continue to rest with Member States.

Goal, subject and structure of the report

The task of the national strategy reports for 2002 is to show how Member States view *long-term* demographic change. Germany has already taken the necessary measures to meet the demographic challenge, in its latest pension reform, approved in 2001 and now being implemented.

Therefore the 2001 pension reform is central to this report. The NSR shows how the reform reconciles social (cf. Goals 1 - 3) and financial policy goals (Goals 4 - 6), assuring socially balanced, fair (Goals 7 and 10) and modern old-age provision for Germany (goals 8,9 and 11):

The pension reform

- aims to limit statutory pension insurance contributions to a maximum of 20% until 2020 and to 22% until 2030;

- Moderately reduces the pension level[2] - though not below 67%;

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[1] Item 43 of the conclusions of the Presidency.

[2] Net pension level is the ratio of an average annual standard pension to calculated average annual net pay. Standard pension is the set old-age pension after 45 years of contributions, each with average earnings insured, minus the average share contributed to health insurance, the share contributed to social care insurance and the average tax incurred on the pension, ignoring further income.

- Supplements this by building up supplementary, voluntary old-age provision, covered by capital, and sponsored to a large extent (sponsorship of the savings expected in 2008 will reach an estimated volume of EUR 12.7 billion), assuring an overall level of provision of 70 percent in 2030.

In this reform, Germany stands by the traditional values of the German pension system - securing living standards, solidarity, fairness to the generations, and equal treatment of the sexes. Germany makes this reform **viable in the long term** by targeted innovation, strengthening of individual responsibility and better cohesion of the three pillars of old-age pension provision. Germany‘s pension reform conforms to the outline principles agreed by the European Council: reasonable pensions, modernisation and assured financial viability of pension schemes.

Employment policy is also very important to old-age pension provision. The Federal Government has designed its employment policy not only to counter unemployment, but to boost employment. In the context of long-term employment strategy, as most recently and fully presented by the Federal Government in its "National Action Plan on Employment for 2002", the goal of a greater share of earnings is very important. The Federal Government has created the appropriate statutory framework for growth and rising employment, to which the tax reform, and reform of the tools of job market policy (the Job-AQTIV Act) will contribute. Further contributions will come from the Act against Unemployment of the Disabled, the Immediate Programme for Reducing Unemployment among Young People, the Part-Time and Fixed-Term Employment Act, the all-Germany "Mainz Model" to promote the uptake of low-paid work, and the Women and Work Programme. In this regard, special attention should be paid to the change of paradigms in favour of an older workforce introduced by the Alliance for Work, Education and Competitiveness (cf. Goal 5).

The 2001 pension reform is the centrepiece of Federal Government’s entire strategic response to the demographic challenge. But it is no isolated measure. Rather, it is embedded in an economic and financial policy which provides a framework of long-term stability and growth, especially through the **ecological tax reform** and the rapid **consolidation of public finances**.

Part Two of the NSR examines each of the 11 shared goals in detail. But first the Introduction gives a brief survey of the problems and challenges tackled by the Federal Government’s strategy and especially by the 2001 pension reform. It also summarises the main elements of these and the principles underlying them.

The Federal Government has involved the *Länder*, the social partners, the pension insurers, occupational old-age pensions schemes and the banking and insurance associations in the preparations for the 2002 National Strategy Report.

Introduction

I. The challenges prompting thoughts of reform

The most recent pension reform (2001) comes at the end of a process of debate in German society about demographic trends which has been gaining momentum since the end of the 1970s, and which had also already led to specific reforms (especially the 1992 pension reform). To meet the future challenges effectively, it was important to gain a clear idea of the nature and extent of these challenges. This NSR therefore starts with a brief survey of the main challenges facing old-age provision, which the Federal Government has taken into account in its overall strategy.

Extreme care is necessary in the methods used to estimate future challenges - especially prognoses and projections - as old-age pension policy has a very long timescale. The results of long-term thinking can only be incorporated in political decision-making with an exact knowledge of the methodological bases and underlying assumptions.

The Federal Government has placed the highest value on this knowledge in devising the most recent pension reform, and emphasises that care is also needed to exchange experience using the open method of coordination. Precisely in this regard, great care and caution are necessary in interpreting and evaluating quantitative data, especially statistical indicators. In working out the "comprehensive plan" required by the European Council, full account must also be taken of challenges which cannot readily be quantified.[3]

The analysis which follows starts from demographic change, the resulting challenges to the income situation of elderly people and the impact of these challenges on public spending on old-age pension provision. The existing prognoses and projections are already sufficiently documented.[4]

In economic terms, the essence of the demographic challenge is that the number of people of earning age will fall, while the number of people past that age will rise. The age quotient (calculated as the ratio of numbers aged 60+ to ages 20 - 60) stood at 37% in 1970, has now risen to 44%, and is projected by the pension insurance report to top 70 % by 2030 (cf. Annex IIIa). The challenge is therefore to provide sufficient goods and services, despite a falling population with earning potential, to afford the whole population a reasonable standard of living. Essentially, therefore, it is a practical economic problem.

There is no side-stepping the fact that a society that wants to assure its elderly people a reasonable standard of living must also set aside the appropriate resources in national economic terms. Reforming pension schemes alone therefore offers only a limited solution to this root demographic problem. Economic, finance and above all employment policies must also contribute to a solution of the problem.

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[3] In some areas - e.g. demographic scenarios and the public expenditure projections based on them - specific and sound results exist. We now have a fairly clear idea of the scale of the challenge facing financial policy. On the other hand, social policy aims must centre on the situation of the individual. The problem with this is methodological: quantitative data on present levels of benefits to pensioners derive from past outline legal and economic conditions, which only partly correspond to the present. It is present-day conditions which determine the situation of future generations of pensioners. It is quite hard to produce micro-simulations, which attempt to predict the situation in 40 or 50 years' time of an individual starting work today. For co-operation at European level, it is important that the better financial policy data now available do not lead to neglect of social policy aims. Where applicable, co-operation at European level must tackle the imbalance in the data now available.

[4] On 24 October 2001 the Economic Policy Committee submitted a document on the public-spending challenges posed by demographic trends: "Budgetary challenges posed by ageing populations: the impact on public spending on pensions, health and long-term care for the elderly and possible indicators of the long-term sustainability of public finances" (EPC/ECFIN/655/01-EN final). Nevertheless, it should be noted that there are no comprehensive projections of public, corporate and private expenditure. It should also be stressed that it would be wrong to draw conclusions about the "quality" of a pension scheme from the results of such projections .

II. From challenges towards solutions

These thoughts highlight the need for a coherent policy mix of the various social and economic policy elements. Labour market development in the coming decades is one of the central strategic variables of old-age pension policy.

On the one hand, as stated, high levels of wage-earning activity and productivity are important preconditions for providing sufficient goods and services, so that the material basis for a high level of old-age pension provision exists. These aspects are at the centre of the Federal Government's employment strategy, as briefly described in the "National Action Plan on Employment 2002". Chapter 1 below shows that old-age pension schemes must be designed to be as employment-friendly as possible, so that they also contribute to employment policy.

On the other hand, in Germany's statutory pension insurance, entitlements are earned mainly through employment. Thus the situation on the job market has a bearing on the achievement of the social policy goals of the pension system. Chapter Two below, on the modernisation of Germany's old-age pension insurance system, deals with these issues.

Employment and old-age pension policy must also be embedded in a stability-oriented economic and financial policy which fully exploits long-term growth potential. Such policies will deliberately leave room for long-term adaptation by an ongoing process of consolidation (cf. point 3).

The following casts further light on these areas:

1. The central importance of success on the jobs market

The following strategically important areas can be identified:

a) Increasing employment: it should be emphasised that measures against unemployment are not enough. Overall employment levels - especially of women and older employees - must be raised further. This is, to some extent, the quantitative element.

b) Lifelong learning: at the same time, production must be as efficient as possible, i.e. productivity must be correspondingly high (this is the qualitative element). This is only true if employees are appropriately trained and qualified, in good health, and motivated.

c) An employment-friendly old-age pension system: the pension insurance system must not militate against the goal of high employment and lower unemployment, but contribute to it.

a) Increasing overall employment, especially of older employees and women, and promoting the quality of work [5]

The overriding priority is to increase employment levels, just as the European Council in Lisbon decided. Progress should be made especially for women and for the group of the older workforce.

Women's employment levels have been steadily rising for long time. This trend should be further supported. Creating equal opportunities on the labour market is advisable for economic as well as social reasons. The 2001 pension reform made major strides in the compatibility of career and family. Special mention should be made here of the child weighting of contribution periods and equalisation measures where more than one child is being looked after (for full information see Annex IV).

[5] Cf. For the "employment level" and "quality of work" aspects, see Chapter B.1. of the "National Action Plan on Employment 2002".

By contrast, employment levels of older workers have long been falling, and now stand at a low level. Combined with longer life-expectancy (and long periods of education, which lead to a late entry into working life), this trend is constantly shortening pensionable periods and extending the time of retirement. Germany has taken the necessary measures by discontinuing early retirement options and raising retirement ages (cf. Goal 5).

To meet the future challenge, efforts in this direction must not slacken in the long-term, as the proportion of younger employees within the working population will decline inexorably and the average age of employees will rise. The economy must adjust to fewer young employees in future, in relative and absolute terms. The benefits and strengths of older employees must be rediscovered. A rethink is therefore necessary. This process began with a change of paradigm concerning older employees by the Alliance for Work, Education and Employability. Another example is the programme "The 50-pluses can do it", the Federal Institute of Labour's placements and qualifications offensive for employees over the age of 50.

The rethink cannot be limited to older employees. It must cover workers of every age. The resulting measures must follow a broad approach, promoting not just employees' qualifications, but their health and motivation, right from the start of their careers, and keeping these factors at a high level throughout their professional development. This places special demands on the social partners, especially concerning in-company further training and working atmosphere. Moreover, Germany's traditional principles of prevention and rehabilitation are gaining in significance. The further improvement of the quality of work should be treated as a permanent task, so that employees are willing and able, as a rule, to work until the statutory standard age-limit of 65.

b) Education and lifelong learning [6]

There is another important trend to remember in this regard: the increasing speed of technical and scientific progress. In itself, this trend is positive, as it raises productivity, and should therefore be encouraged. However, it also demands increasing knowledge and flexibility from employees. There is no sign of any change in this trend in the foreseeable future. It is therefore necessary to invest in the training and further training of people, and makes lifelong learning a matter of course.

The efforts to promote and maintain employees' "employability" and "flexibility" are, and will remain, essential to old-age provision, too. Such efforts support both productivity as a whole and action against unemployment among insufficiently educated people. The NSR does not go into detail on policy in this regard, as pillars I and III of the National Action Plan on Employment 2002 have only recently dealt with it thoroughly. Mention should however be made of the “Job-AQTIV” Act, which came into force on 1 January 2002, and of the Immediate Programme for Reducing Unemployment among Young People. Anyway, it is important to bear in mind the strategic importance of employment policy and lifelong learning to old-age pension provision.

c) Making the pension system employment-friendly

The task of old-age pension schemes is primarily one of social policy, but they should also take account of employment policy aims. It was therefore a major concern of the pension reform to make the old-age pension system as employment-friendly and sustainable as possible. Two aspects can be identified here:

One is that financing statutory pension insurance should not weigh too heavily on the labour factor. This is an important point in a contributory scheme directly associated with gainful employment. The rise in contribution rates must therefore be limited (cf. Goals 6 and 7). The other aspect is that of incentives. This means incentives to work, including allowing those who wish to do so to stay at work after the statutory retirement ages. It also means incentives not to quit working life prematurely. Germany has taken action to reverse the past negative trend in this regard, e.g. by discontinuing tax-free retirement before age 65.

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6 On the subject of lifelong learning, cf. also Chapter B.2.1 of the National Action Plan on Employment 2002.

Early retirement pensions due to redundancy and for women will be phased out completely. On the other hand, people who voluntarily postpone their retirement and continue working will receive pension increments (cf. Goal 5).

2. Modernising the German old-age pension insurance system

To fulfil its social policy function, a pension scheme primarily related to gainful employment must be constantly adapted to the latest developments on the labour market. The pension reform responds to various changes in typical life cycles, employment patterns and family structures.

One especially important aspect was to modernise the old-age pension insurance system to respond better to the changed roles of men and women in the economy and in society. As long as women's situation on the labour market is very different from that of men (e.g. pay levels and promotion prospects, a close correlation with part-time employment, etc.), there is a risk that basing pensions on earning activity *de facto* puts women at a disadvantage. Besides, the idea that the man has sole responsibility for the family income and the woman is adequately covered through the man no longer reflects reality. The 2001 pension reform also contained various measures in response to these changes (cf. Goals 9 and 10). In particular, a new pension splitting option was introduced, allowing both partners an equal share in pension entitlements (cf. Annex IV).

These days it can hardly still be assumed that a person undergoes vocational training and then works full-time in the same job on an indefinite basis until retirement. In fact the world of work has undergone fundamental change in recent decades. On the one hand, "new forms of working" have developed (part-time, fixed-term employment, teleworking etc.). On the other, the scale and structure of unemployment (especially the proportion of long-term unemployed) poses a serious problem (not least in accumulating sufficient pension entitlements). "Breaks" and atypical earning histories are increasingly common. In both cases, the question is how to allow access to a reasonable pension for those who have not earned sufficient entitlements, for whatever reasons (cf. Goal 3). Women benefit especially from many aspects of inter-generation solidarity which tackle this problem (e.g. childcare and child allowance periods, child weighting of pensionable periods, equalisation of disadvantage from caring for several children and allowance for other periods of care).

3. The right economic and financial policy framework

Since the introduction of the European Economic and Monetary Union and the compulsory policy of stability, anchored in the EC treaty, prospects for long-term inflation-free growth have never been so good. Ensuring the stability of the euro and promoting job creation are among the aims of the stability policy of the EU Member States. This in turn provides the material basis for a high level of old-age pension provision.

Sound, sustainable government finance is another important pillar of a stable macro-economic framework. Low public deficits and the avoidance of state borrowing relieve the capital markets. Thus finance policy helps keep prices and interest-rates low. A successful overhaul of government finances permanently reduces state debt servicing and redemption obligations. This leaves room for manoeuvre in finance policy which, in principle, can be used for major future investments, contributing to an increase in economic growth potential, and to further ease the tax burden.

III. The 2001 pension reform and its underlying principles

To present the 2001 pension reform fully here would go beyond the scope of this introduction. This will be rectified in Annex 2. Instead, this introduction presents the basic principles of the reform, and some of its key elements.

The reform is based on the following main principles:

- To preserve continuity and to modernise by targeted innovation;

- To adopt a comprehensive approach which strikes a fair balance between the requirements of social and financial policy; and

- To adopt a strategy which ensures that the system is not only financially but socially and politically viable.

The outline principles established by the European Council in Gothenburg justify this approach. They are: (1) to ensure that schemes are capable of meeting their social objectives; (2) to ensure that they are fundable and (3) to respond to changing social needs.[7]

1. Continuity and innovation

Germany's statutory pension insurance is one of the world's oldest social security schemes. It has repeatedly proved its adaptability and workability, even under tough conditions (e.g. the post-war pension reform and German reunification). It is embedded in a system of old-age provision which rests on three pillars (cf. Annex I).

Since the early 1980s, the demographic challenge to old-age pension provision has been on the political agenda in Germany. It has been thoroughly discussed and has several times led to changes in the pension system. The main example is the provisions of the 1992 pension reform, which made a major contribution to the financial relief of pension insurance. The most important, thorough and innovative reform since 1957 was then implemented in 2001. Certainly the most important innovation is a substantial expansion of supplementary, capital-covered old-age provision, flanked by comprehensive state support.

The introduction of tax-incentivised accumulation of supplementary, capital-covered assets to provide for old age provision was an important point in the political debate about pension reform. Some would gladly have gone further on this point. Others thought the time-honoured principles of social security were in jeopardy. The outcome of this debate takes account of both viewpoints and consists of limited, but major innovation.

Clearly, the aim of the most recent pension reform was not radical change of the old-age pension system. The latest reform is a reform within the system, not of the system. It strengthens the second and third pillars in order better to supplement, not replace, the first. The main pillar of Germany's old-age pension insurance system continues to be the first. This is marked by social security, and stands for reasonable provision for old age based on wages and their development, solidarity, fairness between the generations and equal treatment.

2. A balanced and comprehensive approach

The integrated approach of the pension reform allows both for social and financial policy considerations. The reform follows the principle of fairness between generations. It does not over-stretch either present or future payers of contributions, and keeps benefits at a reasonable level for future pensioners, both men and women (cf. Goal 7).

It sets the rate of contributions at a maximum of 20% until 2020 and at 22 percent until 2030. The reform of the ecology tax plays a decisive share in achieving this objective, channelling the proceeds of the tax into pension insurance.

In the long-term, there is a modest reduction in pension level, to figures between 67 and 68% in 2030. The earnings-related pension adjustment ensures that pensioners share in economic growth, as reflected in wage rises.

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[7] Conclusions of the presidency, Gothenburg, 15 and 16 June 2001, note 43.

Parallel to the reduction in pension levels is the promotion of supplementary, capital-covered provision for old age. The construction of this private or occupational old-age provision is massively supported by the state, which disproportionately benefits those on low incomes and families with children. An annual subsidy of EUR 12.7 billion can be expected for supplementary old-age provision at the final stage, i.e. commencing with savings payments made in 2008.

At the same time, there is a noticeable expansion in solidarity elements in benefit calculations within the statutory pension insurance (especially in old-age provision for women). Reference should also be made to the new law concerning needs-related basic insurance in old age and in case of reduction of earning capacity (cf. Goal 1 and Annex II, point 8).

3. Socio-political sustainability

The 2001 pension reform aims not only to guarantee the financial, but also the social and political sustainability of Germany's old-age pension insurance system. Democratic development inevitably leads to burdens of adaptation. The Federal Government’s primary concern was to share this burden as fairly as possible between and within the relevant generations. Moreover, the intention was to minimise the burden of adjustment on each individual generation, by spreading the processes of adjustment over a long period.

The reform is based on a broad social consensus, which has already been assured by involving the social partners and other relevant organisations in the preparations for the legislative procedure. The reform understands "sustainability" in a broad sense. In principle, financial sustainability is achievable at various levels of provision. But that does not ensure the social sustainability of the system. For the Federal Government, the aim of a high level of old-age provision was, and is, non-negotiable. In the context of the European discussion, let it be said that it is questionable whether a pension system is socially and politically "sustainable" at a low level of benefit which is socially and socio-politically unacceptable.

Crucial elements in the success of the pension reform depend on the voluntary principle, on its acceptance by the population and its active implementation by the social groups and organisations involved, especially the social partners. The Federal Government has therefore provided for a wide range of information.

The strategic goals in detail

A. Reasonable pensions

Member States should safeguard the capacity of pension systems to meet their social objectives. To this end against the background of their specific national circumstances they should:

Goal 1

Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate actively in public, social and cultural life.[8]

The facts

The German pension system is one of income replacement, and therefore very successful at guaranteeing living standards (it is not a basic pension scheme, and there is therefore no "adequate minimum income for older people"). Today's net pension level is approx. 70%.

The vast majority of senior citizens in Germany achieve a reasonable standard of living on their income in old age, as shown by the research for the report "Living Conditions in Germany - the first Federal Government Report on Poverty and Wealth". In the period of the survey, 1973 - 1998, the relative poverty of senior citizens declined markedly and now roughly corresponds to that of the population at large. The problem of old-age poverty, still very serious 40 or 50 years ago, is therefore largely solved.

Elderly people are also less likely than average to need social security. The older they get, the lower the risk is, and it has remained largely constant in recent years. At the end of 2000, just 1.4% of those aged 65+ were on regular income support. Elderly women represent a smaller proportion of the total recipients of regular income support than the proportion of the 65+ age-groups of the population. Elderly women's social security level is 1.5%, below the average of 3.3%. Annex V gives details.

As for the risk of social exclusion, it can merely be mentioned here that old-age pension policy can only aim to offer elderly people the financial and material basis for active participation in public, social and cultural life. The figures quoted above show that this part of the aim is fully achieved in Germany. Of course, policy on elderly people cannot be reduced to financial aspects. The National Action Plan against Social Exclusion for 2001 contains a full description of German policy against social exclusion.

Latest measures and prospects

In the long-term, too, Germany does not expect problems with the above objectives (countering old-age poverty and providing the elderly with a reasonable standard of living).

First, the pension adjustment formula based on wage rises assures future generations of pensioners a share in increasing prosperity.

Secondly, while the latest pension reform moderately reduces the level of pension within the first pillar in the long-term, thereby maintaining the insurance principle, benefit will remain at a high level in 2030: approx. 67 - 68%. In the same period, the relative importance of the second and third columns will increase. Nevertheless the main weight will continue to rest on the first pillar.

Thirdly, building up supplementary, capital-covered old-age provision will not only maintain elderly people's living standards, but actually enhance those currently provided by the state pension. Such capital-covered insurance receives substantial state financial aid. The subsidy will reach an estimated

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8 In this regard, due account should also be taken of benefits other than pensions and tax advantages.

EUR 12.7 billion per annum on expected savings payments for 2008. This will disproportionately benefit insured persons on lower-than-average incomes and families. Accumulation of supplementary, capital-covered old-age pension provision is voluntary, and has only started now. There are therefore no empirical data to describe the exact effects. A detailed presentation is given under Goal 2.

Fourthly, as part of the 2001 pension reform, the Act concerning Need-Related Basic Provision in Old Age and on Reduction of Earning Capacity introduced a new, separate benefits law. As stated, in Germany the problem of old-age poverty has been largely eliminated. Nevertheless, there must be effective ways of protecting those who have not earned sufficient entitlements from poverty in future, by a reasonable welfare system. The introduction of basic insurance will make it much easier for elderly people to assert their justified welfare claims to assure their living standards. It will also considerably improve the living situations of people whose earning capacity is reduced, especially those handicapped since birth or early youth. The Basic Insurance Act comes into force on 1 January 2003 and takes priority over the Federal Social Security Act. Tax-funded basic insurance is a welfare benefit, not an insured pension benefit. It will therefore not be paid by the pension insurance either, and does not constitute either a "supplementary" or a "minimum" benefit (for detail on this see Annex II, point 8).

Goal 2

Provide access for all individuals to appropriate pension arrangements, public and/or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement.

Access to the system of old-age pension provision, especially statutory pension insurance,[9] which is the most important pillar, is designed to be comprehensive. This is reflected in the data from the Federal Government's "Old-Age Pension Insurance Report 2001":[10] in 1999 96% of the population over the age of 65 were receiving benefits from old-age pension schemes which were publicly funded in the whole or in part. This population group of 12.1 million people received benefits totalling more than DM 278 billion. The vast majority of these benefits, 78%, were based on recipients' own entitlements. In the former West Germany, especially, many senior citizens acquired entitlements under several old-age pension schemes. The statutory is the most widespread old-age pension scheme, accounting for an average 80% of total independent old-age pension benefits in the former West Germany and 99% in the former East Germany.

It should be noted here that the statutory pension scheme also includes far-reaching provision for survivors. The 2001 pension reform introduced the possibility of pension splitting. These elements play an especially important role in women's access to pension benefits (cf. Goal 10).

The second and third pillars are already important elements of old-age pension provision in Germany (cf. Annex I). They will gain weight through the accumulation of supplementary, capital-covered old-age provision. In devising the supplementary, capital-covered old-age provision, the Federal Government has ensured the widest possible access and a wide range of provisions. It has also provided special measures supporting it. The accumulation of this private or occupational old-age provision will, as stated under Goal 1, be massively supported by state promotional measures. These will especially favour those on small incomes and families, for whom special incentives are to be provided.

In principle, the beneficiaries are all those covered by the statutory, compulsory pension insurance and who are therefore affected by the limited reduction of pension levels. In addition to employees, these include

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9 All persons in paid employment or employed for vocational training purposes have access to the statutory pension insurance. Some self-employed people in specific occupational groups have compulsory insurance (e.g. craftsman, teachers, tutors and midwives). Those who do not may apply to activate the insurance obligation. Persons not subject to compulsory insurance automatically have the option of voluntary insurance from age 16. Persons who are neither employed nor self-employed are, as a rule, also covered by the pension insurance, especially those on military service or in civil defence, and recipients of wage supplements.

10 The Federal Government submitted its most recent old-age pension insurance report on 23.11. 2001 (Bundestag pamphlet 14/7640).

recipients of supplementary wage benefits, compulsorily insurable care personnel, non-earning parents caring for children, compulsorily insurable self-employed persons and farmers. Furthermore, the measures reforming the statutory pension insurance are uniformly applicable to public servants. This means recipients of established civil-service salaries and official emoluments are also eligible. The fundamental reform of additional provision for the public service, associated with a change of system, now also makes public service employees eligible for benefits.

The following are eligible for support as occupational, capital-covered old-age provision: direct insurance policies, pension funds and pension investment funds and, in the private sector, pension insurance schemes, savings funds and bank savings plans. Savings funds and bank savings plans must be associated with benefit plans and the residual retirement obligation for the oldest age phase. Old contracts can also be subsidised if they meet the conditions of state-supported investments.

The annual expenditure on old-age provision consists of personal contributions and bonuses. The beneficiary just pays his/her personal contributions. The state bonus is credited direct to the eligible contract on application by the beneficiary. The bonus level depends on family status and number of children. If the tax saved by deduction of the special expenditure exceeds the bonuses already paid, the beneficiary receives a further credit of the balance, as part of his/her income tax assessment. The bonus remains on the investment account.

The pension reform has also made a decisive improvement to access specifically to occupational old-age pension provision. Previously, occupational old-age provision was predominantly a voluntary benefit provided by the employer. Since 1.1.2002, employees have in principle been entitled to apply for accumulation of occupational old-age pension provision by paying contributions from their earnings ("income conversion"). Blanket applicability can be expected for whole industries through appropriate collective agreements. Immediate statutory vesting is introduced for entitlements gained through part-conversion of income, to protect entitlements gained, e.g. on changing jobs or termination of employment. Moreover, the general statutory periods for vesting of entitlements where an employer guarantees occupational old-age provision are reduced from 10 to 5 years, while the age limit is reduced from age 35 to 30. The shortening of these periods will be of special benefit to women, who have hitherto often lost their occupational pension entitlements due to the gaps in service due to childcare (for details see Annex II).

Employer contributions to a pension fund or pension investment fund are tax-free. This boosts occupational, capital-backed old-age provision. A legal basis has also been created for tax-free payments by an employer or benevolent fund to a pension investment fund. The pension investment fund then takes over existing pension obligations or entitlements, under certain conditions.

Goal 3
Promote solidarity within and between generations.

Solidarity has been, and still is, a distinguishing feature of the German pension system. That goes both for solidarity within and between generations. Based on the 2001 pension reform, a compromise has been reached which meets the interests both of contributors and beneficiaries.

Solidarity within generations

In the case of the statutory pension insurance, the balance of insurance risks is modified by social elements based on the concept of community solidarity. Contributions to the statutory pension insurance are determined by the individual's ability to pay, and are earnings-related (provided the earnings do not exceed the income limit for the assessment of contributions[11]). Insured persons are covered regardless of their state of health or other risks. Above all, the risk of premature incapacity for earning is covered,

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[11] The income limit for the assessment of contributions marks the ceiling of the statutory pension insurance, up to which the wage or income is pensionable. Contributions are not payable on the part of the earnings which exceed the income limit for the assessment of contributions. An excess does not alter the insurance obligation.

regardless of previous illnesses or of the age of the insured. The pension insurance does not discriminate between sex-specific risks. This works in favour of women who receive equal benefits to men for the same insurance input, despite their different life expectancy. Community solidarity embraces the unemployed and the sick, and people caring for children or relatives.

The statutory pension insurance contains important social equalisation elements. Social equalisation applies to all non-contributory benefits, and those for which the contributions paid do not suffice. Periods of vocational training and of low pay are given a weighting over and above the actual contributions paid during them.

The procedure is different when insured persons cannot engage in their pensionable work because they are unemployed, ill, or looking after a relative. During such periods, other branches of social security (unemployment, health or care insurance) pay the pension contributions. The lawgiver adopted a similar procedure for the periods of childcare, formerly funded by federal subsidy. Since June 1999, the Federal Government has paid current contributions to this out of taxes, based on average earnings. Thus, in this respect, such periods are equated to gainful employment with compulsory contributions (cf. Annex IV).

Solidarity between generations

Solidarity between the generations is the basis and precondition of all contributory pension schemes. Regular adjustment of pensions in line with pay ("dynamic benefit") ensures that the older generation participates in further economic development even during retirement. The reforms which have taken place over the past ten years to adapt statutory pension insurance to demographic change were designed to distribute the foreseeable burdens as evenly as possible across the different generations. A compromise was reached, limiting the rise in contribution levels, as an indicator of the burden on the younger generation, while the net pension level, as an indicator of the burden on the older generation was not allowed to drop below 67%. This can be seen as an expression of solidarity between the generations (cf. Goal 7).

B. Financial sustainability of pension systems

Member States should follow a multi-faceted strategy to place pension systems on a sound financial footing, including a suitable combination of policies to:

Goal 4

Achieve a high level of employment, in particular through comprehensive labour market reforms as provided by the European Employment Strategy and in a way consistent with the BEPG.

As stated in the introduction, a high level of employment is an important factor in the financial viability of the pension system.[12] This is an important aim of the recently presented "national action plans" of the European employment strategy, and will therefore only be presented briefly here (older employees are considered under Goal 5).

After German reunification, employment levels in the 15 - 64 year-group first dropped continuously, reaching their lowest point in 1997: 63.7%. In the following years, an upward trend set in, which has continued to date. In 2000 the figure for those in gainful employment stood at 65.4%. Given this positive development in recent years, Germany is confident that it can reach both the Stockholm interim target (67% by 2005) and the Lisbon target (70% by 2010). Women's employment levels have also risen continuously in recent years, and stood at 57.7% in 2000. Thus Germany already fulfils the interim target agreed in Stockholm (57% in 2005).

[12] To illustrate the order of magnitude, it should be mentioned that a rise of 200 000 in employed persons liable for compulsory insurance roughly yields an increase of EUR 1 billion in contributions received. That in turn would reduce the contribution by 0.1%.

The Federal Government has created the appropriate legal framework for growth and employment to continue to develop in future years. The reforms of tax law, pension law, and the tools of labour market policy (the “Job-AQTIV” Act) form part of this. So do the Act against Unemployment of Disabled People, the Immediate Programme for Reducing Unemployment among Young People, the Part-Time and Fixed-Term Employment Act, the all-Germany "Mainz Model" to promote the uptake of lower-paid jobs, and the Women and Work Programme.

The Immigration Act, which comes into force on 1 January 2003, will, in the long-term, also make a major contribution to attenuating the demographic problem and meeting the growing need for qualified personnel.

In principle, the benefit structures of the statutory pension insurance in Germany are devised to give incentives to get a job. In principle, pension levels are based on pay received throughout working life. Each month of gainful employment by a person liable to compulsory insurance increases his/her pension entitlement, as do increases in income subject to social security payments.

Germany's statutory pension insurance further contributes to high employment levels in the benefits it grants to participation. These benefits especially promote the earning capacity of employed people in the second half of their working lives. Benefits for medical recuperation and for participation in working life in many cases successfully reduce or eliminate limitations of the earning capacity of insured persons. They thus avoid premature reduction of income. In 2000, 958 758 people were receiving benefits for medical rehabilitation or participation in working life.

The stronger prioritisation of active aid over passive makes the Federal Social Security Act increasingly oriented towards integrating social security claimants into the labour market.

Finally, the 1992 and 2001 pension reforms limit the rise in contribution levels, thereby helping not to over-burden the labour factor and thus to ensure jobs and competitiveness. Model-based calculations dating back to 1987, before the 1992 pension reform was passed, showed that without the reforms, the contribution rate would have doubled to around 36% by 2030.

Goal 5

Ensure that all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers; that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age; and that pension systems facilitate the option of gradual retirement.

In the early 1990s, older employees' share in gainful employment bottomed at 49.6% for the 55 - 59 age-group (1993) and 17.6% for the 60 - 64 age-group (1994). Since then, the proportions of both age-groups in gainful employment have risen steadily. In 2000 the figures were 56.5% (55 - 59 age-group) and 19.9% (60 - 64 age-group). Despite this positive development, Germany's proportion of 55 - 64-year-olds in gainful employment, 37.5%, is still far below the Stockholm target (50% by 2010).

A long-term increase in older employees' share in employment is an important part of Germany’s overall strategy of adjustment to demographic trends.[13] The provisions of employment policy and pension law overlap here. The latter, however, only take full effect on expiry of the interim periods provided to protect confidentiality. Germany therefore can expect greater progress in raising the employment quota over the longer term. The pension law allows a gradual transition into retirement and also contains financial incentives to those desirous of working beyond the statutory retirement age. On the other hand,

[13] Annex III a) uses percentages of elderly people to give an idea of the order of magnitude of the importance of older employees. If it proves possible to raise the actual retirement age, currently barely 60, to 65, the result will be an increase in the quotients of elderly people modified accordingly (i.e. the ratio of figures for people aged 65+ to those aged 20 - 65) from 26% today to 46% in 2030.

the employment policy measures are geared to further training, financial incentives to employers, intensified and targeted efforts to find jobs for the unemployed, and briefing work. Mention should be made of the following individual points:

Employment policy measures

To achieve the necessary increase in older people's share of earnings, a change of paradigm on the labour market was required in connection with older personnel. The Alliance for Work, Education and Competitiveness introduced this change in March 2001. In future, the priorities of action on the labour market will be: to increase employment of older personnel, instead of having them leave gainful employment early; the precautionary prevention of unemployment; and the return to work of the existing unemployed. Changes in working conditions and organisation and the framework of social law must also make a major contribution to keeping older people in work longer. The legal measures proposed by the Alliance partners have already been implemented and are presented in detail in the Employment Policy Action Plan for 2002.[14]

> Mention should first be made of the improvement and extension of the tools of labour market policy achieved by the "Job-AQTIV" Act. Under this Act, the labour administration encourages small and medium enterprises with up to 100 employees to obtain qualifications for employees aged 50+, by meeting the costs of further training, provided the employer continues to pay their wages. This measure, limited to four years, makes older employees more competitive and increases their chances of permanent employment in the company. Secondly, the previous age limit for older people returning to work has been reduced from age 55 to 50, and is included in the Act as a temporary provision until 2006. The purpose of this provision is to improve the employment prospects of elderly people and permanently to save them from long-term unemployment.

In addition to the change of paradigm introduced by the Alliance for Work, the following measures are important.

Information and placement initiatives are being sponsored as part of the rethink described in the introduction. Mention should be made here of the Federal Institute of Labour's programme "The 50-Pluses Can Do It". As early as 1999, the Institute addressed employers with its campaign "Older Employees - Competent, High-Performing and Flexible", to motivate employers to recruit older personnel. The campaign highlights the competence and experience of older employees, and has been continued since 2000 as a placement and qualification campaign entitled "The 50-Pluses Can Do It". The initiative follows a twofold approach: to return older employees to work, or keep them in work, and to meet companies' growing need for specialist personnel. In autumn 2001, the campaign was thoroughly revised. Just under 200 advertisements with 120 million reader contacts have promoted the employment of older people.

Mention should also be made of the Part-Time and Fixed-Term Employment Act, which came into force on 1.1.2001. The new provisions of this act offer better opportunities for employing older unemployed people on fixed-term contracts, thereby facilitating their return to gainful employment. Under the new law, a time-limitation without objective cause (time limitation facility) is only allowed for new appointments. A fixed-term contract of employment without objective cause for the fixed term may not exceed two years. A contract of employment initially concluded for shorter term may be extended a maximum of three times, to a total term of two years. Under §14 para. 3 of the Part-Time and Fixed-Term Employment Act, employees are no longer subject to these restrictions after age 58. This means that fixed-term contracts of employment with no objective grounds for a fixed term may be concluded with employees of this age group for longer than two years, and may be renewed more than three times. It should, however, be noted that there must be a gap of at least six months between previous indefinite employment and such fixed-term employment. In reducing the age limit to 58 (from 60 under the old law), the Part-Time and Fixed-Term Employment Act aims to improve the chances at least of fixed-term employment for age-groups with a particularly high tendency to unemployment.

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[14] The Job-AQTIV Act is presented in detail in Annex 2 to the *National Action Plan on Employment 2002*.

As a further counter-measure to the practice of early retirement, employers who dismiss older employees of long standing have to refund their unemployment benefit contributions (for up to 24 months after their 58th birthday).[15] Under Social Security Code III §143a, redundancy money can only be offset against the claim to unemployment benefit under specific conditions. However, redundancy money continues to affect unemployment benefit claims where the employment was ended without due notice to the employer. In this case, the claim to unemployment benefit lapses for the period of notice which was not given.

The Act Promoting a Sliding Transition into Retirement and the associated Act concerning Part-Time Working in Old Age, which entered into force on 1 August 1996, ended the previously widespread practice of early retirement. The Act concerning Part-time Working in Old Age makes it easier to reconcile old age and work.

Pension insurance measures

A series of pension insurance reforms commenced as early as 1992 and were continued in 1996 and 2000. They aim sustainably to increase older employees' share in gainful employment:

- In particular, it will in principle only be possible to retire before the statutory retirement age of 65 in future by accepting a 3.6% reduction of total pension per year of premature retirement. This reduction applies throughout retirement.

- Conversely, continued working beyond age 65 is rewarded by bonuses of 6% per year of delayed retirement.

- Finally, the part-pension option allows a flexible transition into retirement alongside gainful employment and supplements the provisions for part-time working in old age of labour law.

Specifically:

Special, early old-age pensions from age 60 will no longer exist for employees born after 1951. For older insured persons, the option of retiring at 60 will remain, though associated with reductions of pension.

- The original old-age pension due to redundancy was converted to an old-age pension due to redundancy or after part-time working in old age in 1997. This slowed the rise in retirements due to redundancy and, instead, promoted continued employment as part-time working in old age. In addition, the tax-free age threshold was raised from 60 to the statutory retirement age of 65. The introduction of pension reductions associated with this was brought forward and accelerated. This raising of the retirement age was concluded with effect from the end of 2001.

- Accordingly, the raising of women’s retirement age, of 60, has been brought forward and accelerated. Nevertheless, the raising of women’s retirement age to the statutory threshold and the introduction of pension reductions only started at the beginning of 2000 and will be completed by the end of 2004. As an interim measure, lower reductions continue to apply to women born before 1942, due to special provisions for the protection of confidentiality. These measures will therefore take effect increasingly over the next few years.

- The reductions applicable to early retirement are equal to the longer period of retirement compared with retirement at the statutory age of 65, and therefore apply as long as the pension is received. The amount of pension payable is reduced by 3.6% per year of early retirement. The maximum reduction is 18% for retirement at 60.

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15 Social Security Code III §147a.

In the long-term, retirement before the statutory age of 65 will only be possible for those who have been insured for many years (35 eligible years under pension law) and for persons insured as disabled for many years.

- Persons insured for many years, who were born before 1948, can retire at 63 at the earliest. The age for retirement without loss of pension was raised in 2000 and 2001 in stages to the statutory age of 65. In this case, too, the reduction is 3.6% per year of early receipt of pension, i.e. a maximum of 7.2% of the amount of pension payable. For insured persons born in or after 1948, the age for early retirement therefore falls progressively to 62 from 2011. The maximum reduction for insured persons born after October 1949 will then be 10.8%.

- For disabled persons insured for many years (35 years of eligible periods under pension law with severely disabled status), born after 1940, the age of retirement without loss of pension rises in stages from 60 to 63. The reduction on early retirement is also 3.6% per year. On completion of the rise, with effect from the end of 2003, the maximum figure will be 10.8% of pension paid. Under a provision for the protection of confidentiality, however, disabled persons born up to 11 November 1950 and who are disabled and incapacitated for work on 10 November 2000 are exempted from the raised retirement age.

One incentive for staying longer in working life was created as early as 1992, by the introduction of what are known as part-pensions. Instead of full retirement as soon as the conditions for early retirement are met, claiming a full pension, the option has existed since 1992 of continuing to work at least part-time while drawing one-third, half or two-thirds of the pension as a "part-pension". In addition to the part-pension, gainful employment is allowed to an agreed extent, i.e. an additional income may be earned up to three different limits. This allows insured persons to postpone receipt of full pension. In this case, only the part-pension received is subject to reductions.

Those who do not draw the old-age pension after reaching the usual retirement age of 65 receive bonuses of 6% per year of non-receipt. If they continue working, such a bonus also applies to the pension entitlements thereby accrued.

In future these measures can be expected to lead to a visible increase of older employees' share of paid work, because the measures combine the option of flexible retirement with strong incentives to work.

<u>*Goal 6*</u>

Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt[16]*. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds.*

The decision to build up supplementary, capital-covered old-age provision represents a historic step towards modernising Germany's old-age pension insurance system. This reform puts the funding of old-age provision on a firm basis for the future. The balanced combination of contributory and capital-covered processes leads to greater diversification of risk and therefore more efficient and secure investment in old-age provision. It also improves the framework for the working of the capital markets and hence contributes to growth and employment.

Financing by capital cover is also in line with the principle of personal responsibility. As described under Goal 2, the state support criteria are designed to allow persons on low incomes and families with children to accumulate assets to provide for their old age, with a high level of state support. This also gives this group of people a share in the benefits of a mix of old-age provision financed by contributions and by capital coverage.

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[16] Member States' strategies to ensure sound and sustainable public finances are reported and assessed in the framework of the BEPG and the Stabililty and Growth Pact and should be in accordance with these.

For future generations of pensioners, extra pension from the state-supported assets for old-age provision makes a higher level of overall provision possible for previous generations.

The concept of sustainable finance policy is especially closely linked to the issue of fairness between the generations. Given the background of foreseeable demographic change, the concern must be to create the best possible situation here and now to meet the relevant financial challenges. Strict public spending limits, lower budget deficits and a successful carry-back of interest payment obligations are important elements of the comprehensive strategy for greater fairness between the generations. The Federal Government therefore aims to balance the budget as quickly as possible (both the federal budget and that of the country as a whole). As agreed at European level, the goal for the whole state is roughly to balance the budget in 2004. The federation itself has set itself the target of balancing the budget by 2006 and thereafter, depending on the economic situation, to redeem debts or use any extra room for manoeuvre to reduce the tax burden further.

The restructuring of public finances becomes "active" if accompanied by a restructuring of pension insurance aimed at sustainability. The 2001 pension reform strikes a new balance in the finance of the statutory pension scheme and makes it viable in the long term. Traditionally, German discussion has centred on the level of employee contributions to pension insurance as an indicator of financial burden. In a way, this represents one of the most important benchmarks of pension policy in Germany. Clear, reviewable targets have been set to keep the level of contributions below 20% until 2020 and below 22% until 2030.

The policy of limiting contribution levels is based on the following elements: first, various regulations concerning "marginal" part-time workers have made around 4 million jobs pensionable for the first time and have halted the seemingly inevitable erosion of the contribution base. Secondly, the ecological tax reform has released extra funds for pension insurance. This ensures that general state pension insurance tasks can now be financed as the system requires, i.e. from the federal budget. Thirdly, the adjustment of pensions has been modified, slowing the rise in pensions.[17]

The effects of two further measures to stabilise contributions should also not be ignored. One is the gradual raising of the preferred retirement ages from 60 and 63 to a uniform 65, associated with pension reductions in case of early retirement, which is still allowed (as described under Goal 5). This measure already formed part of the 1992 pension reform. The stages by which the ages are raised have meanwhile been brought forward and accelerated. The other measure is the reform of pensions for reduced earning incapacity, effective from the start of 2001. This replaces the occupational disability pension and pensions for reduced earning capacity with two levels of benefit for reduced earning capacity. A claim to such a pension depends exclusively on how the insured person performs with regard to health on the general labour market. The "occupational protection" associated with the past occupational status of an insured person now only exists under a confidentiality protection provision for insured persons born before 1 January 1961.

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[17] The pension adjustment procedure has been amended in the three respects: (1) from 2001, apart from gross wage rises, account will only be taken of changes in contribution rates if they have an impact on old-age provision, i.e. the level of contributions to pension insurance and to state-supported provision. Changes in income tax and in the level of contributions to the Federal Institute of Labour are unaffected. This is appropriate because developments on the labour market no longer affect pensioners (any more). Pensioners no longer pay income tax on a standard pension, not including further income. (2) Allowance for the accumulation of state-supported old-age provision acts as a further brake on adjustment. This accumulation takes place in 0.5% stages from 2003 to 2010, with the effect of reducing adjustment. In principle, this implements the provisions within the European system of national general economic accounting with regard to net income of employees. (3) From 2011 a factor within the adjustment formula will mean the changes in pension insurance contribution rates will carry rather more weight within the pension adjustment formula. Given that changes of the rates of contribution to pension insurance are expected to be upward rather than downward, savings may result from this. For pensioners, this means a moderate share of future taxes resulting from demographic change.

Finally it should be borne in mind that German reunification has led to an increase of the proportion of federal funding, and that this specific financial burden will steadily fall as time goes by.

As a result of these measures, the pension system makes a significant contribution to assuring the viability of public finances.

It should also be pointed out in this regard that the 2001 statutory pension reform measures have been applied uniformly and systematically to provision for civil servants. The additional provision for public service employees, based on the provisions for civil servants, has been reformed.

In Germany, the goal of reasonable pension provision is non-negotiable,[18] and pensions continue to be based on earned entitlements. Inevitably, therefore, it must be admitted that this goal comes at a price. As highlighted in the introduction, it is easier to achieve the goal of financial sustainability if employment levels rise accordingly (see Goal 4). Successes at controlling early retirement by older employees actually pay off twice, as pension benefit is payable later and income from contributions increases.

To ensure that the development in contribution rates in no way exceeds the envisaged targets, the recent pension reform imposed a statutory obligation on the Federal Government to propose suitable counter-measures to the legislative bodies if the parameters appear likely to be exceeded.

Annex III shows the development of contribution rates on which the Federal Government's planning is based.

Goal 7
Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter. This equally requires that those in gainful employment should not be overburdened, and that pensioners should receive reasonable pensions.

To achieve such a balance conforms to the twofold goal of the latest pension reform: on the one hand, not to overburden payers of contributions (and therefore to limit the necessary rise in contribution levels) and, on the other, to reduce the pension level moderately in the long term. As shown in the previous chapters, this reduction is more than offset by the voluntary accumulation of the supplementary, capital-covered old-age provision. It is also enacted in a socially balanced way, by the disproportionate support to people on low incomes and families.

Annex III describes this balance. The 2001 pension reform ensured that contribution levels to employed persons' pension insurance would not exceed 20% until 2020 and would not exceed 22% until 2030. The pension level, the ratio of net standard pension to net average income will not fall below 67% until 2030. This keeps the rise in the rate of contribution, made inevitable by demographic change, to an acceptable level, without overburdening generations of pensioners. Annex III, attached, contains a model-based calculation of the contribution level and pension level within the forecast period of the pension insurance report (2001 version). Annex III also shows the total level of provision (including the supplementary, capital-covered provision), which will rise above 70% by 2015.

Goal 8
Ensure, through appropriate regulatory frameworks and through sound management, that private and public funded pension schemes can provide pensions with the required efficiency, affordability, portability and security, particularly where there is greater recourse to such schemes.

To ensure that capital-covered old-age provision schemes are efficient, adequate transparency of the markets for the relevant products is necessary. Citizens can only know which of the available pension products meet their personal preferences if transparency exists as to what benefits can realistically be expected from such a product, what payments are necessary during the saving stage, and how high the

[18] Moreover, as stated in the introduction, the objective of reasonable pensions is very important to politico-social sustainability.

management charges for the various products are (see below). Private and occupational old-age provision organised on the open market can only lead to efficient results if such transparency is ensured. Security is especially important with forms of old-age provision based on capital coverage. This necessitates both supervisory legal regulations, arrangements in the event of insolvency, and investment provisions for securities.

It is important that the management charges for private old-age pension products are transparent to potential clients. There is, therefore, a statutory obligation on the provider of the supplementary, capital-covered old-age provision, supported by the state under Germany's latest pension reform, to give the client written information about the expected management charges, before conclusion of the contract.

Precisely with regard to the last point, reference should also be made to sound cost-effectiveness of the statutory pension insurers. First, it should be noted that management costs are quite low under the statutory pension insurance. In 2000 management and procedural costs accounted for just 1.6% of the total receipts of the statutory pension insurance. The proportion of management costs has also steadily fallen in the past three decades, with the exception of a temporary rise due to extension of the pension to the former East Germany in the first half of the 1990s. Today it is about one-fifth lower than in 1970.

By introducing the 'pension investment fund' option, the pension reform has added to the forms of occupational old-age provision (previously there were four options: 'direct guarantee', the 'benevolent fund', 'direct insurance' and the 'pension fund'. The 2001 pension reform also authorised the internationally successful 'pension investment fund' as a means of building up occupational old-age provision. Cf. Annex I in this regard). The Old-Age Assets Act of 26 June 2001 governs the introduction of pension investment funds as lawful devices for occupational old-age provision (Article 10: Amendment of the Insurance Supervision Act). Unlike conventional pension funds, pension investment funds do not owe interest on contributions. The capital investment risk is borne either by the employer (guaranteed benefit) or the employee (a commitment to contribute with minimum benefit on contributions received). They are collective investment funds, which must cover the biometric risk of longevity and may, as an option, cover invalidity and survivors' insurance. The employer pays in the contributions. Employees have the option of sharing in them by income conversion. Greater freedom of investment gives pension investment funds the opportunity to manage the invested capital to an international standard, to generate higher returns. This makes for more efficient occupational old-age provision and reduces expenditure on it. To guarantee the security of money invested in old-age assets, the operation of the business and its own equity capital (solvency) are monitored by the supervisory authority. In the case of pension investment funds, protection in the event of insolvency also exists through the mutual Pension Security Association. Pension investment funds will strengthen Germany as a financial centre. Because of the longer-term nature of investments, pension investment funds will be oriented more towards assets of substance, such as equities and other holdings. This will lend further impetus to the capital market and thereby also to growth and employment.

The Insurance Supervision Act contains three essential powers of decree with regard to: (1) capital investments; (2) the necessary equity (capital provision) and (3) the formation of a premium reserve (showing provision obligations as liabilities). These powers are described in Annex VI.

C. Modernisation of pension systems in response to changing needs of the economy, society and individuals.

Since the 1957 pension reform, the economic and social framework in which the German old-age provision system operates have changed radically. During this development, the needs of the economy, society at large and individual citizens have undergone fundamental change. It was therefore time to adapt old-age provision in Germany to the new realities.

The 2001 pension reform has done this. Special attention should be paid here to the massive support for the accumulation of supplementary, capital-covered private and occupational old-age provision, by tax breaks and state bonuses. As shown under Goal 6, the greater risk diversification also makes more efficient forms of investment possible, and enhances the security of old-age provision. These innovative financial reforms mark a decisive and successful breakthrough in the modernisation of Germany's old-age provision system. The innovative combination of tried and new forms of finance meets the present-day needs of the individual (greater room for individual configuration and personal responsibility), of the economy (more efficient capital markets) and of society (ensuring the financial and political sustainability of the old-age provision system).

Goal 9
Ensure that pension systems are compatible with the requirements of flexibility and security on the labour market; that labour market mobility within Member States and across borders and non-standard employment forms do not penalise people's pension entitlements and that self-employment is not discouraged by pension systems.

Flexibility, security and 'atypical' employment

As stated in the introduction, the world of work is changing rapidly. This calls for more flexibility and, at the same time, brings greater uncertainty. Mention should be made of the trend towards a smaller proportion of indefinite, full-time employment, while self-employment, fixed-term employment, hiring-out of temporary labour, part-time or marginal employment and other 'atypical' methods of earning are growing in importance. Gaps due to unemployment, and the need for career change should also be mentioned. This development brings those in gainful employment many opportunities, but also risks. The changing conditions of the world of work are leading to increasing breaks in individual work track-records (gaps, stages of part-time employment, switches between different forms of working, etc.). Such breaks in track-record often entail fluctuating income. Even with appropriately designed old-age provision schemes, this may lead to individual deficits in old-age provision. It should be remembered here that the risk of such deficits is greater for women than men, as women are over-represented in non-standard earning forms (cf. Goal 10). Social security is required to offer people the necessary security to make them able and willing to respond flexibly to economic change. Germany has already responded to these challenges in the past, and has done so again in the 2001 pension reform.

In past years in Germany there have been a series of reforms which have adapted the statutory pension insurance in this respect to changes in the world of work. As early as 1992, the existing regulations on 'benefit according to minimum income' were considerably extended. This meant that persons insured for a relatively long time on comparatively low pay could top up their pensions beyond the value resulting from strictly equal treatment. Since 1998 employed people on flexible working hours which allow longer periods of release (e.g. sabbaticals) have also been assured full pension insurance cover during such periods. This is especially important to insured persons who become incapacitated for work during such periods. Since 1999, persons engaged in certain atypical forms of employment, who were previously not normally covered by the statutory pension insurance, have also earned pension entitlements under the statutory scheme (marginal employees and self-employed persons with no employees of their own).

The latest pension reform made new provisions limiting the impact of breaks in employment track-record on subsequent pension levels. In particular, gaps at the start of individual work histories, especially in the transition from education to work, have been 'closed' as far as pension law is concerned. This will lead to higher pension entitlements, especially for working people who had such difficulties embarking on their careers, were finally able to make a successful start in working life, but then became incapacitated for work prematurely.

Finally, the latest reform act also introduced regulations improving the pension entitlements of women who take up part-time employment during the childcare stage. A reduction of working hours (part-time employment) due to care of children or others does not lead to unreasonable losses of pension entitlements, because below-average wages in such cases are 'topped up' by 50% - 100% of average income, for pension calculation purposes. This applies until a child is 10 years old (plus the benefit of the three-year childcare period). Where nursing care is provided, it may even apply until the child is 18, provided 25 eligible years under pension law have been worked, including the childcare periods (cf. Annex IV). If gainful employment is impossible due to simultaneous care for two or more children, carers who can prove that they have worked 25 eligible years under pension law, including periods of childcare, receive maximum credit.

In addition to these measures adapting the statutory pension insurance to a changing world of work, the latest pension reform also contained provisions to improve the compatibility of occupational old-age provision with the requirements of flexibility and security on the labour markets. The goal of these measures was, in particular, to abolish provisions making it difficult for employees to change companies, when they would forfeit their occupational pension entitlements. Two new provisions increase employee mobility. The first is the immediate statutory vesting of occupational old-age provision entitlements acquired by income conversion. Secondly, the general statutory vesting period for employer-funded guaranteed occupational old-age provision is reduced to 5 years, and the age threshold to 30. This favours women especially. These provisions seem appropriate and reasonable in order not to undermine employers' willingness to invest in the qualifications of their employees.

The Federal Government accepts the principle that cross-border mobility should not lead to unreasonable loss of pension entitlements.

> This is guaranteed in the EC/EEA states by application of Regulation (EEC) nos. 1408/71 and 574/72. The aim of these regulations is to ensure that the exercise of freedom of movement does not fail due to barriers in social law. Moreover, the German Federal Republic has concluded a series of social security conventions with non-EC/EEA states. One aim of these conventions is that people who were employed or self-employed in Germany and the relevant partner state should not suffer any disadvantages in pension law from this.

Self-employment must not be discouraged by pension systems.

In Germany, the self-employed are only covered by social security where a special need is identified (e.g. farmers, craftsmen and artists). The pension insurance allows for the special position of self-employed activity, for example, by giving the occupational group of self-employed craftsmen the option of obtaining release from compulsory pension insurance, if sufficient cover already exists (at least 18 years' of compulsory contribution periods). For self-employed persons with only one customer and no employees of their own, temporary release is allowed at the start-up stage, plus the possibility of definitive release for the older self-employed who have already engaged in such activity before and are now compulsorily insurable for the first time.

Goal 10
Review pension provisions with a view to ensuring the principle of equal treatment between women and men. This should be done in accordance with the obligations deriving from EU law.

Statutory pension insurance

The provisions of Germany's statutory pension insurance are neutral between the sexes (the previous different retirement ages for men and women have been abolished by the staged rise in retirement age for women born since 31.12.1939).[19]

The introduction showed the need for further progress in the compatibility of family and work. The inter-generation solidarity payments mentioned under Goal 3 are formulated not to discriminate between the sexes (childcare and child allowance periods, child weighting of contribution periods, equalisation of disadvantage of care of more than one child, and allowance of other periods of care). This means men, too, who meet the necessary conditions, can be favoured under pension law, though these remain exceptional cases. As a rule, women provide care of children and others, so that women regularly benefit from the positive treatment of such care. The latest pension reform already contains important steps in this direction, by improving the relevant framework, namely:

- In addition to the three-year childcare allowance to boost pension, low pay during childcare is rounded up for the calculation of pension.

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[19] There is one exception to this: where mother and father care for a child jointly, the parents may make a concurrent declaration deciding which parent is allocated the childcare and allowance periods. If the parents have made no such concurrent declaration, these periods must be allocated to the mother. This provision has been made because the social reality is that, even in cases of joint childcare, mothers usually provide most of the care.

- A settlement is provided for women who cannot work even part-time, due to the care of at least two children.

- Childcare is taken into account to enhance provision for survivors' pensions.

- In the case of supplementary, capital-covered old-age provision, the child bonus is usually credited to the woman. The social reality is that she still regularly does most of the care work.

In this regard, the question must also be raised of what happens to pension entitlements in case of divorce. The provision settlement, i.e. the settlement of entitlements acquired during the marriage, follows the principle of equal treatment of men and women even in the event of divorce. In practice most such settlements apply to pension insurance entitlements. After settlement of the provision, both spouses acquire equal entitlements. The latest pension reform has also introduced pension splitting, allowing an equal sharing between spouses of pension entitlements acquired during the marriage. This extends women's independent old-age provision (cf. Annex IV).

Occupational old-age provision

In principle, in the past, occupational old-age provision has already offered women advantages over private old-age provision. Tariffs are often more attractive in occupational provision, while the unisex tariffs normal in many cases increase returns for women. Despite these advantages, in the past women were under-represented in occupational old-age provision as holders of entitlements in their own right. The lawgiver has recognised this and improved the framework conditions accordingly.

The individual entitlement to occupational old-age provision by income conversion is expected to increase occupational old-age provision among women, in particular. The reduction of vesting periods also favours women, who had previously often forfeited their occupational pension entitlements due to childcare-related breaks in working activity.

So that women suffer no disadvantages by taking up 'parenting time', full account is taken of these periods in calculating the duration of the statutory vesting periods.

Private old-age provision

Private pension insurance is also calculated according to sex in Germany. Women have a longer life expectancy, leading to longer pension lifetimes. This means women are estimated to receive 9 – 12% less monthly pension than men, for the same contribution. The sex-related calculation conforms to the principle of equal treatment under insurance law. Women are still under-represented in existing and new pension insurance policies and supplementary insurance for occupational incapacity. The state support introduced in 2001 means an increase in women's share can be expected.

Goal 11
Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. Develop reliable and easy-to-understand information on the long-term perspectives of pension systems, notably with regard to the likely evolution of benefit levels and contribution rates. Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.

Citizens' trust in an old-age provision system is decisive to its sustainable workability. Such trust can only be elicited or retained if people have access to vital information on how the various old-age provision schemes work and on the development of costs and benefits of these schemes. Thus the creation of transparency is an important element in a sustainable policy on old-age provision.

Transparency and reliable information about future costs and benefits of the statutory pension insurance are also an essential condition for insured persons to be able seriously to plan their supplementary, capital-covered old-age provision under the second and third pillars (see below).

In Germany, citizens have many ways of obtaining information both about the statutory pension insurance in general and, in particular, their personal pension entitlements. Many of these information options are based on statutory obligations of the Federal Government to submit reports which are analysed and commented on publicly by experts (e.g. the Social Advisory Board), as part of monitoring. There is also an obligation of insurers to provide information to the individual insured persons. The latest pension reform requires insured persons to be sent information about their entitlements automatically (i.e. without having to take action themselves) and regularly.

Under Social Code VI §154, the Federal Government must submit a 'pension insurance report' to the legislative bodies by 30 November each year.[20] The report describes the financial position and development of the statutory pension insurance, and how the raising of retirement ages is affecting the employment market, the financial position of the pension insurance and other public budgets. In particular, the report contains special information about the necessary contribution level for the next 15 years (the contribution level is one of the key indicators in the discussion of the future financing of pension insurance in Germany).

In addition, the pension insurance report must be supplemented once in each parliament by the 'old-age provision report', which describes the benefits and funding of the publicly financed old-age provision schemes and should give a survey of the income situation of beneficiaries in old age.

The Social Advisory Council, pursuant to its statutory task (Social Code VI §155) gives its opinion on the annual pension insurance reports from the Federal Government. This body was set up in 1957 in connection with the then pension reform, and numbers twelve members. They include scientists from the social and economic science fields, a representative of the Bundesbank and representatives of the pension insurers, trade unions and associations of employers.

The publication of these reports and the analysis and commentary by the experts of the Social Advisory Council contribute to an objective and transparent public discussion of the development of the old-age provision system.

Insured persons and pensioners covered by the statutory pension insurance in Germany have the option of obtaining information and advice from the statutory pension insurers. For this purpose, a well developed network of regional advice centres has been established. In 2000 more than 3300 employees of the statutory pension insurance advice centres gave information in more than 3.7 million customer contacts.

Insured persons in Germany have long had the option of requesting what is called a 'pension statement' from their pension insurer. This lists all eligible periods of service under pension law and the resulting pension entitlements. From 2004, statutory pension insurers are further bound to send all insured persons (from age 27) an annual "pension information report". This pension information report states the pension entitlements so far earned and the level of the resulting benefit for incapacity for earning. It will also contain an estimate of the future old-age pension, assuming that the previous gainful employment is continued until retirement age. Thus insured persons are regularly informed on the future benefits they can expect from the statutory pension insurance, and can plan their supplementary capital-covered old-age provision early.

After age 54, the pension information is supplemented by a triennial pension statement giving information on the level of pension under the law in force, and general notes on fulfilment of the personal and legal insurance conditions for a pension entitlement.

[20] The Federal Government submitted its latest pension insurance report on 23 November 2001 (Bundestag pamphlet 14/7639).