Report of the German Social Advisory Council on the Federal Government's 2005 Pension Insurance Report and on the 2005 Old-Age Security Report

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I. Introduction

1. In accordance with its statutory duty (section 155, Social Code, Part VI), the German Social Advisory Council (GSAC) comments on the belatedly presented Federal Government's 2005 Pension Insurance Report. This statement addresses firstly the economic development in the year 2005 as well as the political measures regarding pensions discussed in the 2005 report. Thereafter, the details of the 2005 pension insurance report that refer to future development, i.e. projections over the medium-term and the model calculations for the next 15-year period, are addressed. In conclusion, the 2005 Old-Age Security Report is also considered.

2. The GSAC makes its comments based on its access to the calculation results and to information on underlying assumptions as well as to the text of the 2005 draft report on the pension insurance scheme. The GSAC was also able to approach the Federal Ministry of Work and Social Affairs for additional information and explanation.

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II. Economic development 2005

3. The stronger economic impetus hoped for earlier failed to materialise in 2005. Economic growth weakened, down from 1.6 percent in 2004 to 0.9 percent in 2005. In 2005, as in previous years, the minor increase in gross domestic product was export-led. In comparison with 2004, the real export volume rose again by 5.5 percent. But another disappointment was that domestic demand virtually stagnated. This can be attributed, in particular, to a continuing weakness in consumer demand.

4. This had an impact on the labour market. The number of unemployed rose by about 480,000 persons, as an annual average from 4.38 million in 2004 to 4.86 million in 2005. As a result, the average unemployment rate increased from 10.5 percent to 11.7 percent. This increase is largely attributed to the introduction of the basic social security measure for those looking for work (unemployment benefit II). This has had a purely statistical effect: with these new regulations effective from January 1st, 2005, recipients of social security who are capable of working and were thus not registered as unemployed previously, are now listed as unemployed.

5. The number of employed has remained virtually constant, albeit showing a slight decrease in comparison with the previous year. A particular cause for concern is the fact that the number of the employees liable for social security contributions has again fallen considerably. Here, marked differences between the old and new Länder are apparent. While the old Länder suffered a decrease of “just” 1 percent, in the new Länder the number of employees liable for social security contributions decreased by about 3 percent. However, latest available data indicate that the fall in the number of jobs liable to social security contributions is being halted, and possibly that a reversal in this trend will take place.

6. The decline in employment that is liable to social security contributions has affected the finances of the Statutory Pension Insurance. The income from compulsory contributions in 2005 has turned out to be about 460 million Euros lower than in the previous year. This corresponds to a reduction of 0.3 percent. In contrast, the contributions made by the Federal Agency for Work (*Bundesagentur für Arbeit*) increased by about 400 million Euro (4.0 percent). Taking into consideration other types of

contribution, the total income from contributions declined by about 390 million Euros or 0.2 percent.

7. The merger of unemployment benefit and social benefit that was laid down in the framework of the "Fourth Act for Modern Services in the Labour Market" (*Viertes Gesetz für moderne Dienstleistungen am Arbeitsmarkt, Hartz IV*) had a positive effect on the financial position of the Statutory Pension Insurance. In line with the new regulations on unemployment benefit II, the Federal Agency for Work now also pays contributions to the Statutory Pension Insurance for those formerly classified as social benefit recipients capable of working. The overall effect of these additional contributions is diminished as the contributions of the former unemployment benefit recipients are on average lower. Nevertheless, this results in additional contribution income amounting to about 600 million Euros in total. In the first instance, i.e. as long as those contributions do not lead to a benefit claim, the Statutory Pension Insurance experiences an unburdening effect. However, to put this in perspective, if this subgroup claims ever more rehabilitation measures pension expenditure will increase in the long-term because of these additional entitlements and the (temporary) relief will fade.

III. Bringing forward the federal subsidies and claiming the federal guarantee

8. Poor economic development and the difficult situation on the labour market have also had an effect on the Statutory Pension Insurance, especially since with the “Second Act to Change the Social Code, Part VI” (*Zweites Gesetz zur Änderung des Sechsten Buches Sozialgesetzbuch*) the

legislator has already reduced the lower target value of the corridor for the sustainability reserve fund (*Nachhaltigkeitsrücklage*) to 20 percent of one month's expenditure. As already commented on in the Social Advisory Council's reports of 2003 and 2004, this can have a negative affect on liquidity for a period of less than a year in the Statutory Pension Insurance. This was indeed the case in 2005.

9. While the development of the pension insurance's expenditure is relatively even for a period of less than a year, the contribution income is variable in specific months. This is not a new development rather it is due to — among other factors — one-off payments by employers (e.g. bonuses, Christmas bonus) as well as seasonal labour market effects. The year before, those normal fluctuations in contribution income in a period of less than a year coincided with three other developments that had a burdening effect on the liquidity of the pension insurance. Firstly, this was due to the poor economic development noted in the previous chapter and the difficult situation in the labour market; secondly, the sustainability reserve fund, which was already low at the beginning of the year, and thirdly, the reduction of the minimum reserve to 20 percent of one month's expenditure following the "Second Act to Change the Social Code, Part VI" (*Zweites Gesetz zur Änderung des Sechsten Buches Sozialgesetzbuch*). The confluence of these factors has resulted in the pension insurance having insufficient liquid financial reserves at its disposal from September to November to pay pensions. Therefore, in the short term the Statutory Pension Insurance had to rely on additional means to guarantee the payment of the pensions.

10. To balance income fluctuations and to guarantee the regular payment of pensions, “bringing forward the Federal Guarantee“ and “bringing forward the contributions for child-rearing periods“ are two instruments available to the pension insurance to balance its financial position. The “bringing forward” measure allows the federal funds that were intended for the current year to be claimed early. However, it is not possible to bring forward federal subsidies at the end of November as the next instalment of the federal subsidy due at the end of December is by that point already put down for the pension payment for the January of the next year. Budgetary regulations do not allow this final instalment to be made available for pension payments in the current year. When contributions for child-rearing periods are insufficient to bridge the liquidity squeeze, a federal liquidity subsidy (the Federal Guarantee) must be claimed — as happened in 2005. In this case, the federal government provides the pension insurance institutes with an interest-free loan.

11. In 2005, from September onwards, subsidies had to be claimed early — as was also the case in 1984 and 1985. By the end of October, 1.3 billion Euros of the federal subsidy that was due in November had already been transferred to the pension fund. At the beginning of November, further federal subsidies amounting to about 500 million Euros were claimed early. This financed contributions to the pensioners’ health insurance as well as the risk-structure balancing in the federal health insurance funds. However, for the first time a liquidity support amounting to 900 million Euros had to be drawn on end the end of November. But looking at 2005 as a whole, no additional means were necessary since the liquidity support provided by the government was paid back in December 2005.

12. In line with the risk-structure balancing in the Federal Health Insurance, after the first week of each month the Statutory Pension Insurance pays an amount equal to 0.9 billion Euros into the federal health insurance funds. If on this date the Statutory Pension Insurance is unable to pay with its liquid assets — as it was the case in December 2005 — the payment date can be put back to the 18th of the month in question. Thus, the financial drain arising from short-term liquidity needs is shifted to the health insurance funds, which — in contrast to the pension insurance — can finance their liquidity requirements through external resources if necessary.

13. In this context, the GSAC points out that despite the liquidity fluctuations in a period of less than a year the pension insurance' ability to pay was and is guaranteed at each point in time. However, the GSAC sees the risk — as already pointed out in previous reports — of the Statutory Pension Insurance being discredited in the public eye because of its short-term liquidity problems.

IV. Bringing forward the final payment date for the full social insurance contribution

14. From January 1st, 2006, the latest payment date for the full social insurance contribution has been brought forward to two days before the last bank working day of the month. This one-off bringing forward of the payment date should allow the Statutory Pension Insurance to bridge the short-term liquidity problem caused by, among other factors, the difficult economic environment.

15. The payment date for the full social insurance contribution is geared to the previous legal position on the payment date for the wages and salaries: For wages and salaries that were paid by the 15th of the month, the full

social insurance contribution had to be paid by the 25th of the month; for wages and salaries that were paid after that date the full social insurance contribution had to be transferred by the 15th of the following month. From January 1st, 2006 when the "Act to Change the Social Code, Part IV and Part VI" (*Gesetz zur Änderung des Vierten und Sechsten Buches Sozialgesetzbuch*) came into effect, the full social insurance contribution must be paid two days before the final bank working day of the current month – irrespective of the date when wages and salaries are due.

16. Because the payment date for the full social insurance contribution has been brought forward the majority of employers will pay 13 contributions to the social insurance in 2006 as the social insurance contributions for December 2005 as well as for every month of 2006 (including those for December) become due in the changeover year. As wages and salaries are also due mid-month, the social insurance contributions related to these will, accordingly, be paid in the same month, so that in addition only about 80 percent of the monthly compulsory contribution is due. For all social insurances this corresponds to an amount of about 20 billion Euros that has to be paid some 19 days earlier.

17. Private companies suffered a financial burden of about 16 billion Euros due to the payment date for the full social insurance contribution being brought forward: about 80 percent of social insurance contributions are made within the private sector. In total, private employers are likely to incur continuing costs of about 400 annually for financing this measure — if the 16 billion Euros per month have to be financed at an assumed interest rate of 5 percent for 15 days. The additional financial burden is likely to be different for each individual company. While the additional burden for some

companies is likely to be limited to lost interest from financial investments, other companies have to bear the higher financial costs of bearing this through borrowing. This regulation also puts a higher burden on labour intensive companies.

18. State employers – the Federal Government, Länder and the municipalities – are affected by the earlier payment date of the full social insurance contribution. This includes local authorities that pay their social contributions by the 15th of the month following the remuneration payment as they have shifted the date for the remuneration payment from mid-month to the end of the month, according to a collective agreement made in January 2003. These state employers face ongoing costs of financing the payment of about 60 million Euros per year.

19. The legislator provided a temporary measure so that small and medium-sized businesses, in particular, avoided suffering an excess burden because of the changeover. Under this, it is possible to divide the social insurance contributions that fall due on the new date from January 2006 into tranches worth of 1/6 of the contribution liability to be paid monthly between February and July. For the first time this allows a division of the social insurance contributions. It remains to be seen, however, the extent to which such a division of the contribution benefits such companies as it involves an administration burden. The GSAC regards the additional administrative effort of dividing contributions as high in small and medium-sized businesses in particular.

20. Furthermore, the changes required to determine the contribution rate are also going to add to the administrative burden for such companies.

Previously, the final bill for contributions was not calculated until after the accounting month had ended. This meant that all the relevant information for the payment was available by the time the bill was issued and thus the transfer of the social insurance contributions could be fully accounted for. Under the new regulation, companies have to transfer the total social insurance contribution by the second day before the final bank working day of the current month and prior to that – sometimes a couple of days before – they have to present proof of contributions made to particular health insurance funds. This means that the expected full social insurance contribution has to be calculated already by about the 20th of the current month. The final bill for contributions is prepared only in the following month when all data is available. For this, the employer must calculate the difference between the expected and actual contribution liability and has to offset this through the contribution payment in the following month. The present remuneration statement, which is mostly done in one accounting process, has therefore been split into two.

21. Out of the estimated additional income, which amounts to about 20 billion Euros representing one month's expenditure, 9.6 billion Euros is brought forward on account for the Statutory Pension Insurance. This corresponds to revenue of approximately one contribution rate point. A realistic alternative to bringing forward the payment date for the full social insurance contribution, other than increasing the federal subsidy, the only other measure which could have been considered would be increasing the contribution rate to the Statutory Pension Insurance. To generate corresponding additional income, an increase in the contribution rate of about one percentage point would be necessary. Because of the adjustment

rule[1] the additional financial burden resulting from the increased contribution rate would accrue only until the sustainability reserve fund has been replenished to an amount equal to 150 percent of one month's expenditure. On the employers' side, increased contributions would have led to increased labour costs; on the employees' side, disposable income would have been reduced, and the federal government would have had to increase the federal subsidy by 2 billion Euros. In addition it would have caused a further interim increase in the gap between the producer's and consumer's wage with corresponding negative effects for the economy as a whole. Moreover, such an increase in the contribution rate would have meant that the legal target value for a contribution rate under 20 percent (until 2020) would have been broken.

22. After considering all the arguments, the GSAC regards bringing forward the payment date as a problematic solution that can only be justified when taking into consideration the disadvantages of increasing the contribution rate, which otherwise would have been necessary.

V. Altering the index-linked changes of the federal budget's allocations

23. The phrase "The index-linked changes of the federal budget's allocations to the Statutory Pension Insurance are stopped" in the coalition agreement of November 11th, 2005, has caused difficulties in interpretation for the GSAC

[1] Under the adjustment rule (*Verstetigungsregel*) set out in section 158, subsection 1, Social Code, Part VI, the given contribution rate has to be maintained so that the sustainability reserve fund does not fall below the minimum value of 20 percent of one month's expenditure or exceed the maximum value of 150 percent one month's expenditure forecast for the end of the following year.

(as well as elsewhere). In any case the pension insurance report leads to the conclusion that this phrase does not entail pension political measures as the statement shows that a stopping point of index-linked changes of allocations from the federal budget is reached “on the basis of the regulations currently applicable”. The pension insurance report says that “the increase in the coming years is considerably below the corresponding index-linked amount of previous years despite an additional one-off contribution from the federal government”. The yearly average growth rate of federal subsidies from 2005 to 2009 amounts in to, in effect, about 1 percent, assuming that current forward projection rules continue to apply and taking into consideration the one-off additional federal subsidy in 2008 of 600 million Euros. This value of 1 percent is considerably below the corresponding index-linked increase seen in past decades of about 6 percent. However, this reduction of the index-linked adjustment is based in particular on the disproportionate increase in federal subsidies to the pension insurance rather than legislative changes. This increase in federal subsidies is due to the introduction of an additional federal subsidy financed by the value-added tax and by an increase in the amount of this additional federal subsidy financed by the ecology tax in recent years.

24. On examining combined federal budget allocations to the Statutory Pension Insurance (both from subsidies and contributions), those allocations are initially reduced due to the measures presented in the pension insurance report of 2007 coming into force. But in subsequent years the allocations rise again in accordance with the current law – and beside from the proposed additional one-off contribution from the federal government in 2008 of 600 million Euros. The reduction in allocations from the federal government to

the pension insurance in 2007 is, on the one hand, due to the decrease, equal to 22 billion Euros, in pension insurance contributions paid by the federal government on behalf of recipients of unemployment benefit II (see Chapter VI). On the other hand, following the draft of the accompanying budget law (*Haushaltsbegleitgesetz*), the ordinary federal subsidy will be reduced from July 1st, 2006. The reduction is equal to the pension insurance's additional contribution income from the increase of the lump-sum contribution rates for short-time employment from the current 12 to 15 percent as well as limits set on exemptions from social insurance contributions for bonuses paid on basic wages of up to 25 Euros per hour for Sunday, bank-holiday and night working. The stated intention is to reduce the burden on the federal budget through means of additional income from contributions – estimated at 170 million Euros in 2006 and 340 million Euros in subsequent years.

25. In addition, increasing social insurance contributions expressly to lessen financial pressure on the federal budget causes problems under constitutional law. Following the judgement handed down by the Federal Constitutional Court that social insurance contributions cannot serve as a means of general fiscal provision for the state, such contributions must be concerned with, and limited to, financing the social insurance fund. The legislator is not allowed to use its regulatory powers regarding the social insurance system to pass measures to provide means to finance general public expenditure. The financial assets of the social insurance fund are effectively and legally separate from the general public assets. Therefore, using social insurance contributions to finance the general needs of the state is not possible.

26. In the opinion of the GSAC, the social insurance systems and thus also the Statutory Pension Insurance should not be excluded from measures

relating to budget consolidation. But the trust of those insured in the Statutory Pension Insurance is not upheld if federal assets are regarded as means to consolidate the budget, especially since in earlier years compensation for benefits that were not contribution-financed and the overall responsibility of the federal government for the stability and robustness of the Federal Pension Insurance were beyond dispute. The financial planning of the Statutory Pension Insurance allows for federal contributions, and the loss in income resulting from suspending the continued adjustment of such contributions has to be financed accordingly. Compensation for such a change can only happen if contribution rates increase or benefits are reduced. But an increase in the contribution rate contradicts the objective also set out in the coalition agreement, namely that the contribution rate to the Statutory Pension Insurance should not exceed 19.9 percent until 2009. If the federal government ends the previously envisaged index-linked increase of federal subsidies, then benefits have to be reduced.

VI. Reducing contributions for recipients of unemployment benefit II

27. In an attempt to reduce expenditure on basic security benefits for those looking for work, it was agreed in the coalition agreement to reduce the pension insurance contribution for recipients of unemployment benefit II from 78 Euros to 40 Euros per month. In addition, the law that was in the meantime passed by the German Bundestag “Act to Change the Social Code, Part II and other laws” (*Gesetz zur Änderung des Zweiten Buches Sozialgesetzbuch und anderer Gesetze*) makes some recipients of unemployment benefit II to be exempt from compulsory social insurance. Those exempt are benefit claimants who — as well as receiving

unemployment benefit II — are either in jobs that are liable to social insurance contributions, are self-employed or are employed as the recipient of an income compensation benefit under Section 3 Clause 1 No 3, Social Code, Part VI. This measure should reduce expenditure within the context of unemployment benefit by about 2.2 billion Euros. As contributions for those benefit claimants were previously paid by the federal government, the federal budget is therefore unburdened. However, as a countermove contributions are withdrawn from the Statutory Pension Insurance. In the short- and medium-term the Statutory Pension Insurance faces an additional burden, as compensation for the missing contribution income by means of savings on the benefit side only takes place in the long-term.

28. The contribution reduction to 40 Euros is only roughly half the contribution that is due based on the minimum contribution assessment basis for the voluntary insured and for the self-employed who are liable for insurance contributions (e.g. business start-up premium (*"Ich-AG"*)). But even paying a reduced contribution the insured acquires entitlements equivalent to a full compulsory contribution month in respect of rules regarding social insurance law for pensions and rehabilitation measures. This puts the government in its role as a contributor at an advantage since the present minimum contribution assessment basis that applies to other insured persons — at present 78 Euros — does not apply to the government itself.

29. When compulsory insurance for recipients of unemployment benefit II was introduced the pension insurance institutes pointed out that 78 Euros is sufficient only to cover entitlement to a standard old-age pension. The additional costs entailed by claiming other benefit entitlements (e.g.

pensions in respect of a reduced earnings capacity or rehabilitation measures) have to be provided by all those insured. The reduction of the amount from 78 Euros to 40 Euros that has already been announced means that the loss in income expected to total approximately 2.2 billion Euros has to be raised from the budgets of the existing pension insurance institutes.

VII. Raising the state pension age

30. The GSAC welcomes a gradual increase of the state pension age to 67 years. Increasing the state pension age is the correct response to higher costs generated by an increase in the number of years a pension is drawn due to increased life expectancy. The increase in state pension age should be designed in such a way that employees and employers have time to be able to prepare for the changed legal position. Furthermore, confidence in the system within the terms of constitutional law must be preserved.

31. When discussing the state pension age the fact that the average age at which an old-age pension begins to be drawn has increased in previous years. While it was at 62.3 years in 2000 it rose to 63.1 in 2004. This increase occurred, it has been argued, because of reductions in pensions made when retirement is taken early. One must make a distinction from the change in the average pension age for recipients of pensions for reduced earnings capacity, which has declined from 51.4 to 49.8 years in the same period. This decline indicates that the pension for reduced earnings capacity is regarded as an instrument used in the case of early retirement to a lesser extent than it was previously. The average pension age of 60.8 years in 2004 that is mentioned frequently when discussing the subject is based on the calculation of a simple average of the age at which both old-age pensions

and pensions for reduced earnings capacity begin to be drawn. This simple average pension age therefore distorts the true picture.

32. With the convergence of the actual pension age to the state pension age that is again and again demanded, a distinction has to be made between the financial effects in the short- and in the long-term that result from this convergence. In the short-term, the increase in the actual pension age reduces pension expenditures and thus has a positive impact of the financial situation of the pension insurance; but cost neutrality results in the long term. This is because while pension payments are paid over a shorter period the amount of each pension payment is, by the same token, higher. The payment difference corresponds to the balance between reductions in case of early retirement and additional pension entitlements acquired in line with a longer working life. As the reductions in the Statutory Pension Insurance are actuarially correct from the Pension Insurance Institute's point of view, early retirement is cost neutral in the long-term for the Statutory Pension Insurance. But this does not mean that early retirement is not associated with losses for the economy as a whole and also with a loss in income for other kinds of social insurance.

33. The financial effect on the pension insurance caused by a rise in state pension age is difficult to estimate as to make such a calculation long-term projections for the cohorts entering retirement and the pool of pensioners are needed. Moreover, the decisive determining factor is the behaviour of those insured. Deferring retirement on an old-age pension by two years could reduce the contribution rate by 2030 by about half a percentage point. This estimate takes additional contribution income as well as reduced pension expenditure into account. But under current law, one also has to take into

account additional expenditure since pension entitlements increase accordingly with each additional contribution year. Furthermore, there are other factors that have an influence to bear which must be taken into account, for example, the planned alternative that a full pension can also be claimed below the age of 67 after the equivalent of 45 years worth of contributions have been acquired.

34. In the long-term, the ratio between pensioners to the employed grows more favourable because of an increase in the state pension age. If conditions remain in other respects the same, a higher pension adjustment is generated through the sustainability factor in the pension formula. Moreover, the insured acquire additional earning points because of having a longer working life. For those insured who work until they reach the state pension age, pension entitlements increase in the long-term. However, lengthening working life is likely to reduce the rate of return on contributions in the Statutory Pension Insurance for those who retire during the transition period. Thus the GSAC suggests an analysis of the exact effects on changes in the rate of return due to raising pension age limits.

35. Furthermore, it should be pointed out that one cannot by any means assume that all persons affected do, in fact, retire two years later. Some insured will certainly retire early as a consequence of a reduced earnings capacity. Others will accept a reduction and take retirement early at the age of 65. However, as the reductions are in the view of the pension insurance actuarially adequate, it is unlikely that the long-term savings effect will be reduced. Nevertheless, costs will be temporarily incurred for the initial financing of this measure.

36. The planned special regulation that will allow those insured persons with a minimum of 45 compulsory years of contributions arising from employment, child-rearing and caring periods, can continue to retire at 65 without a reduced pension is not only a negation of the equivalence principle, it also partially negates the possible savings effect from raising the state pension age.

37. Despite a poor economic environment, the employment rate for people aged between 55 and 64 has risen slightly in recent times to 41 percent. However, this still falls considerably short of the 50 percent that is aimed for under the Lisbon Strategy. It is noticeable that employment rates among the over 60s depends heavily on professional qualifications. Following an analysis by the Institute Labour and Technology (*Institut Arbeit und Technik*) older workers who are highly qualified are almost four times more likely to be in employment than older workers with low qualifications.

38. Moreover, an international comparison shows that in other national economies (with a comparable development stage) employment rates among older workers are considerably higher than in Germany. The Scandinavian countries are of particular note in this context.

39. The GSAC is aware of the fact that an increase in the state pension age will only be accepted among population if employment rates among older people can be raised. But it has to be pointed out that the precarious current labour market situation for older workers is partially, though not solely, the result of a failed practice of early retirement in previous years.

40. In the GSAC's opinion, an increase in the state pension age has to be accompanied by instruments of both employment and labour market policy

because of current low employment rates among older people. This is also stated in the coalition agreement. Only then can a hidden pension reduction due to an increase in the state pension age be avoided. Instruments to promote the employment of older people are found in the first and second law for modern services in the labour market. Furthermore, all opportunities to increase the integration of older workers into the labour market should be utilised. To do this, measures such as identifying jobs targeted at older workers can be improved and the drive to life-long learning through additional qualifications can be intensified by the time workers reach middle age. Among other things, the model of a youth-orientated work-force should be questioned in companies and the supply of age-based jobs should be improved.

41. The health-related aspects of a longer working life should also be taken into account. The idea of prevention and rehabilitation is therefore to be strengthened. The rehabilitation benefits of the Statutory Pension Insurance add demonstrably to the preservation of the earnings capacity of all workers.

VIII. Taking individual employment characteristics into consideration

42. The cabinet has decided that insured people with 45 years worth of contributions can retire at the age of 65 without suffering a pension reduction. The possibility of claiming a full pension that is not dependent on the number of contribution years is inconsistent with the principle of equivalence contained in the Statutory Pension Insurance. The lack of any pension reduction in the case of early retirement would breach this principle. Assuming that both retire at the same age, a long-term insured person would receive a higher pension in comparison to someone who had acquired the

same number of earning points in fewer than 45 contribution years. Therefore, the latter faces a reduced pension. It would mean that rather than the amount of contributions paid, the way contributions are distributed over the course of the insured person's working life would determine the amount of pension received after the age of 65. This weakens the connection between contribution payments and the amount of pension received and gives pension insurance contributions the characteristics of a tax. The existing pension law allows for the long-term insured to claim an old-age pension before reaching the state retirement age. An insured person with 35 insured years can retire two years before reaching the state pension age – albeit with the correct reduction.

43. In its agreed form, the planned regulation to allow long-term insured to receive a pension without reductions before reaching the state pension age would also have serious social-political consequences. Such a regulation would cause unwelcome and wide scale distribution effects. Those with an interrupted work history would be "punished" for this in old age. This problem is amplified if the development towards interrupted work patterns continues. Those particularly affected by these changes are workers with low qualifications and especially women. A special analysis by the Federation of German Pension Insurance Institutes (*VDR*) showed that of all those who retired in 2002 only one in every 13 female pensioners (7.5 percent) had acquired a minimum of 45 years in contribution and consideration periods (e.g. child-rearing periods) while almost half of the men (47.1 percent) had reached the 45-year minimum. Those who have had temporary periods of self-employment or are in professions that have separate insurance schemes

provided through professional associations would also be discriminated against.

44. One characteristic of the social insurance scheme is that it allows no individual risk selection or risk adjustment. This is the principle difference between it and private insurance schemes. If in the future, the pension amount is differentiated according to the number of contribution years acquired or because of working in a particular job or profession, one must ask why the pension amount should be determined only according to such criteria. Once a precedent has been created, the way is open for consideration of other characteristics (e.g. gender) to be demanded. Such a development would ultimately lead to an individualisation of the risk of longevity and therefore would make the reason for the existence of the Statutory Pension Insurance open to question.

45. Therefore, the GSAC opposes unanimously the cabinet decision to permit those with 45 years-worth of compulsory contributions to retire at the age of 65 on a full pension. Such preferential treatment of the long-term insured would damage the basic principles of the Statutory Pension Insurance. In addition, it would generate undesired distribution effects for women in particular.

46. This argument also holds true for differentiation in the state pension age through special regulations governing particularly arduous occupations, a measure that is sometimes demanded in political debate. Moreover, in the opinion of the GSAC it is not possible to make such a differentiation. No adequate differentiation for occupations that are physically more strenuous exists.

47. This is also clear in the current discussion on reforms of the "Hackler rule" in Austria. The existing "Hackler rule" allows early retirement for workers in certain occupations that demand strenuous labour. But this rule has been heavily criticised, so it was decided to introduce a new "Hackler rule" by 2007. The debate shows the difficulties to agree on a generally accepted definition for the type, time and extent of work that is physically and mentally strenuous. In addition, insured persons who spend a large part of their working life in a strenuous occupation are unlikely to achieve 45 contribution years. There are more likely to retire early on a pension with a reduced pension amount, i.e. an occupational incapacity pension (*Berufsunfähigkeitsrente*) or an invalidity pension (*Invaliditätsrente*).

48. The GSAC advises against a reintroduction of the occupational incapacity pension that was for good reason abolished. The occupational incapacity pension was granted in cases when a person could no longer pursue their former occupation. It was abolished with justification in 2001 – apart from transition rules — due to social injustices generated by this type of pension. The GSAC regards further developing pensions for reduced earnings capacity as the correct response to problems that can arise from undertaking strenuous labour and an increase in working life. However, one must point out here that a reform to the pension for reduced earnings capacity should not become a gateway to early retirement.

IX. Pension value adjustment and compensation for the slowing effect produced by the security clause

49. The annual pension adjustment is based on the development of the sum of the gross wages and salaries per person employed in the previous year. The contribution income of the Statutory Pension Insurance however is

based mainly on the development of wages and salaries that are liable to contributions, but those values are known only after a longer time lag. That is why the rate of change of the sum of the gross wages and salaries per person employed is corrected for the pension adjustment. If, for example, the wages and salaries liable to contributions have risen more slowly the year before last than average gross wages and salaries — because, for example, of an increased remuneration conversion for occupational pension schemes — the pension adjustment turns out to be lower.

50. Moreover, according to the adjustment formula the pension increases are reduced if either the contribution rate to the pension insurance has been increased; the share paid into an additional old-age provision scheme that should represent the contribution to the Riester pension has increased; or if the ratio of (equivalence-) pensioners to (equivalence-) contributors has increased. However, a security clause in Section 68 Subsection 6, Social Code, Part VI in conjunction with Section 255e Subsection 5, Social Code, Part VI prevents these slowing factors causing a cut in pensions. Without this security clause, pensions would have already been reduced in 2005 and also in future years. That means that only with higher nominal wage increases can these factors cause the intended slowing effect on the pension adjustment.

51. The difference between the development of the employees' wages on the one hand and the pension on the other hand that was assumed in earlier projections is not maintained because of the security clause. As a consequence, the pension level will be higher. This in turn requires a higher contribution rate. These effects are permanent, i.e. they are not automatically counter-balanced in subsequent adjustments. Thus this security clause

threatens the statutory target of stopping the contribution rate from rising above 20 percent until 2020 and above 22 percent until 2030.

52. The security clause always comes into effect when for a number of years the growth rate of the average wage and salary sum is not high enough to guarantee that either an increase in the contribution rate, the “Riester Steps”, or the triggering of the sustainability factor — all of which decrease the pension adjustment — work to their full extent. The pension level permanently exceeds its planned target level each time the security clause is put into effect. Therefore financing this increase in pension level requires a higher contribution rate in subsequent years.

53. In the coalition agreement it was therefore agreed to compensate (or to “catch-up”) for pension reductions in future years when wage and salary growth is stronger since pension reductions have been omitted since 2005. However, this change will not come into effect before 2010. In the projections, the “catching up” was considered in such a form that the omitted pension reductions accumulated since 2005 reduce the pension increases from 2012 onwards. The reduction is planned to occur in stages of 0.4 percentage points per year over five years. It would, surely, have been preferable if the government had also set out in concrete terms its proposals for such a “catch up factor” rather than simply describing in abstract form the intended effects of this new element in the pension adjustment formula.

54. The targets for the contribution rate and pension level determined in the 2004 Pension Insurance Sustainability Act aimed at providing sustainable financing for the Statutory Pension Insurance conflict with the security clause in Section 68 Subsection 6, Social Code VI in conjunction with

Section 255e Subsection 5, Social Code VI that is intended to prevent pension reductions and a worsening of the financial position of pensioners. When wage and salary growth is low this conflict is relevant as it is then, when the security clause comes into effect, that the pension level changes in a fashion incompatible with the contribution targets. Compensating for the omitted pension reductions does, undoubtedly, serve to meet contribution targets, but it can lead to a development of a pension amount that could put the authority and the functionality of this old-age security system at risk.

X. Expanding the security clause

55. Following the draft of the "Act for the Preservation of the Actual Pension Values from July 1st, 2006" ("*Gesetz über die Weitergeltung der aktuellen Rentenwerte zum 1. Juli 2006*") even a negative development of the gross wages and salaries per average employee should not cause a reduction of the actual pension value. In effect, this entails expanding the scope of the security clause (cf. Section 68 Subsection 6, Social Code VI in conjunction with Section 255e Subsection 5, Social Code VI) so that a reduction in pension value as a result of dampening factors in the adjustment formula is prevented. Although the law concerns only the 2006 pension adjustment, the government has set a target of no pension reductions in the current legislative period. This would mean that the link between pensions and the development of gross wages and salaries that has existed since 1957 is abolished. Pensioners would profit from an increase in wages and salaries per average employee but would not be suffer from any negative development.

56. In this case, the absolute ruling out of pension reductions has two effects. On the one hand, the financial situation of the Statutory Pension Insurance

worsens as a decrease in contribution income occurs in tandem with pension expenditure that remains constant (if not rising). On the other hand, it is likely that this regulation has a negative effect on public confidence in the Statutory Pension Insurance in the mid- and long-term as it triggers uncertainty. Indeed, in the short-term a public outcry against pension reductions can be avoided, but this comes at the expense of pensions not being adjusted under the "catch-up" factor in times of gross wage increases per average employee. It is easier psychologically to convince pensioners of the need to make sacrifices in times of economic difficulty, i.e. when wages fall, than tell them years later that their pensions will not increase even when gross wages per average employee increase.

57. The GSAC opposes an expansion of the security clause in regard to a negative development of the gross wage per average employee. Ruling out reductions even in the case of a decline of the average wage causes a squeeze on the financial situation of the Statutory Pension Insurance and a general loss of confidence in it.

58. The commission "Achieving Financial Sustainability for the Social Security Systems" (*"Nachhaltigkeit in der Finanzierung der Sozialen Sicherungssysteme"*) had proposed in its report that pension adjustments should not be linked to the changes in the gross wages and salaries per employee but exclusively to the change in wages and salaries liable to contributions per contributor. This recommendation was not included in the "Act to Secure the Sustainable Financial Basis of the Statutory Pension Insurance (Pension Insurance Sustainability Act)" (*Gesetz zur Sicherung der nachhaltigen Finanzierungsgrundlagen der gesetzlichen Rentenversicherung" (RV-Nachhaltigkeitsgesetz)*). The pension adjustment

formula passed by the Bundestag is still based on changes according to the national accountings standard. The development of the gross wage and salary sum liable to contributions is taken into account only after a time-lag introduced via a correcting factor. The GSAC advises that an analysis of the effects of using wages and salaries liable to contributions be made.

XI. Statement on the medium-range projections to 2009

59. For the years 2005 and 2006, the 2005 Pension Insurance Report's projection is based on the assumptions of the Government's 2006 Annual Economic Report. For the years 2007 to 2009, the assumptions made by the inter-ministerial "National Economic Projections" team from October 19, 2005 form the basis of the projections. Furthermore, for the calculations the draft of the 2006 Accompanying Budget Law (*Haushaltsbegleitgesetz 2006*) and the draft of the "Act to Change the Social Code, Part II and other laws" (*"Gesetz zur Änderung des zweiten Buches Sozialgesetzbuch und anderer Gesetze"*) are taken into account. In addition, the pension political measures passed by the cabinet on the basis of the coalition agreement of November 18th, 2005, which are addressed separately in this report, are included.

60. It must be noted that the benchmark figures for 2006 were revised downwards considerably in comparison with the estimate made for October 2005, whereas the economic assumptions for the years 2007 and 2009 were retained. Therefore, measures already decided on, such as the increase of the value added tax and the insurance tax but also the "25 billion Programme to strengthen Innovation and Growth", were not explicitly accounted for when estimating the national economic development that forms the basis for the pension insurance report.

61. As in the previous years, the GSAC emphasises that the basic economic assumptions for the pension insurance report are overly optimistic. This applies, in particular, to the underlying assumptions on employment from 2007 onwards. However, the assumptions made for 2006 are realistic, if not indeed cautious. The assumed growth rate for the gross domestic product in 2006 is, at 1.4 percent, at the lower end of the current available estimates.

62. At this rate of economic growth, a fall in the number of registered unemployed, down to average of 4.5 million unemployed, can be expected in 2006. Employment liable to social insurance contributions will decline by 0.29 percent. But signs are growing that after a long period of decline in employment liable to social insurance contributions a slight increase can be anticipated. None the less, an annual growth rate in the number of employees liable to social insurance contributions of about 0.6 percent in the old Länder and about 0.5 percent in the new Länder from 2007 onwards seems quite an ambitious expectation. For these growth rates to materialise additional measures as regards the labour market are necessary in areas the government has already addressed such as, for example, the framework of the initiative “Perspective 50-plus”.

63. The growth rate in the gross wage and salary sum per employee assumed in the pension insurance report of 0.7 percent for the year 2006 may be regarded as realistic. But the annual growth by 1.5 percent from 2007 is likely to be at the high end of what can be realistically expected.

64. On the basis of the assumptions with regards to the employment and wage development, growth rates in gross wages and salaries of 2.0 percent as defined in the national accountings (*VGR*) are seen from 2007 onwards.

With regards to the wage development concerning the contribution income accounted for in the pension insurance report, the expected change in the gross wage and salary sum is reduced by 0.4 percentage points up to and including 2008. This is based on the fact that in previous years the increase in income liable to contributions was less than the gross wage and salary sum, among others due to the remuneration conversion in line with the occupational pension schemes that are exempt from social insurance contributions. If the increase in the wage sum liable to contributions turns out to be 0.1 percentage points less than assumed, the Statutory Pension Insurance's finances risk the contribution income being reduced by 150 million Euros.

65. The medium-range projections show that — as in the years 2004 and 2005 — in 2006 the pensions were not adjusted upwards. When growth in the relevant gross remuneration is too low an increase in the actual pension value is avoided by the "Riester Steps" and the sustainability factor coming into effect, both of which lessen the pension adjustment. However, a pension reduction based solely on these two factors is prevented by the security clause (see Chapters IX and X). Actual data indicates that a decline in gross wages and salaries per average employee relevant for the pension adjustment cannot be excluded in 2005. To avoid a decline in pensions due to this development, the "Act for the Preservation of the Actual Pension Values from July 1st, 2006" ("*Gesetz über die Weitergeltung der aktuellen Rentenwerte ab 1. Juli 2006*"), which prohibits such a decline, comes into force. A reduction in pensions would relieve the financial strain on the Statutory Pension Insurance by 22 million Euros for each 0.1 percentage point.

66. The assumptions concerning the contribution rates to the statutory health insurance for pensioners that are financed jointly by the pension insurance and pensioners themselves also pose financial uncertainties for the Statutory Pension Insurance. The contribution rate of 13.3 percent for 2005 is kept constant over the whole projection period. This assumption seems to be rather optimistic given current conditions and against the background of cost pressures for the Statutory Health Insurance Companies that were triggered by, among other measures, an increase in the VAT rate and a reduction in federal contributions, and the associated risk of a contribution rate increase. The effect of substantive reform in health services already announced cannot yet be assessed but it is likely to have a bearing on the finances of the pension insurance and therefore should contribute.

67. A change in the contribution rate to the pensioners' statutory health insurance that is jointly financed by the pension insurance and the pensioners affects the amount financed by the Statutory Pension Insurance. If the general contribution rate to pensioners' statutory health insurance increases by 0.1 percentage points, the Statutory Pension Insurance's expenditures increase by about 100 million Euros.

68. Following the 2005 pension insurance report, the Statutory Pension Insurance faces a deficit of 4 billions Euros in 2005 together with a decrease in the sustainability reserve fund to 11 percent of one month's expenditure. In 2006 the contribution rate of 19.5 percent can be kept since the payment date for the total social insurance contributions is brought forward, therefore the Statutory Pension Insurance can expect additional contribution income of 9.6 billion Euros in this year. Because of this additional income the statutory requirement of a sustainability reserve fund of at least 20 percent of one

month's expenditure can be achieved. Despite the increase in the pension insurance contribution rate in 2007 to 19.9 percent, the sustainability reserve fund in 2008 would fall short of its minimum value if it were not for a one-off additional federal subsidy amounting to 600 million Euros. Against this background, the reoccurrence of liquidity problems in periods of less than one year cannot be excluded in these years.

69. The medium-range projections from 2007 regarding the Statutory Pension Insurance are as presented based on feasible, albeit optimistic, employment assumptions. Thus the GSAC sees the risk that a renewed discussion about the contribution rate and liquidity could discredit the Statutory Pension Insurance.

XII. Statement on the 15-year projections to 2019

70. The presentation of the long-term financial trends until the year 2019 uses the same methodology as in previous years. Three assumptions regarding wage development are linked to three assumptions regarding employment development giving nine variants in total. The long-term projections serve as a means to test the influence of changes in the various assumptions made about future economic trends. In effect, they clarify how the Statutory Pension Insurance System reacts within particular economic and demographic parameters. In this context, the GSAC points out that these long-term model calculations in the Pension Insurance Report are not prognoses for any future development.

71. The long-term development of the labour market in the old Länder is assumed to be comparatively more positive in the 2005 pension insurance report in contrast to the 2004 report. The development of the labour market

in the new Länder is assumed to be more negative. In the version with the lower employment trend, it is assumed that until 2019 for the old Länder the number of workers and employees stagnates at the current level of about 27.1m and that for the new Länder the number declines by 0.3 million to 4.8 million. In the version with the middle employment trend, the number of workers and employees liable for social insurance contributions rises by 1.3 million in the old Länder whereas in the new Länder the number declines by 0.1 million. In the version with the higher unemployment trend, the number of workers and employees liable for social insurance contribution rises by 2.6 million in the old Länder and the figure for the new Länder the number rises by 100,000.

72. A long-term relaxation of the labour market situation should depend mainly on future economic development and not only be achieved through future demographic changes which are said to ease the strain on the labour market. In particular the higher employment path is ambitious.

73. Compared to previous reports, the long-term assumptions have been adjusted. The average annual wage growth rate for the old Länder is now 1.5 percent, 2.5 percent and 3.5 percent in the three variants. This adjustment — understandably — also no longer assumes a constant wage growth, but rather the growth rate of wage increases themselves show a steady increase from 2010 to 2020. In the middle variant, the growth rate increases from 2 to 3 percent which results in an average yearly growth rate of 2.5 percent. For the new Länder, it is assumed that the wage level of the old Länder is achieved by 2030. Because of this assumption the average yearly wage growth rate is set at 2.4 percent, 3.5 percent and 4.6 percent in the three variants.

74. The GSAC welcomes the decision to lower the paths for wage development in the 2005 pension insurance report. This is in response to a proposal made by the GSAC. The introduction of a gradual increase of the wage development makes a smooth transition to a long-term wage increase of 3 percent in the prognosis with the middle variant possible. Here it has to be stressed that the assumption of a wage increase of 3 percent in the long-term is compatible with assumptions and results of numerous national and international studies. Therefore, one cannot raise objections to the pension information given by the German Pension Insurance that are based on such assumption.

75. Although the results of the long-term calculations can only be illustrations, it is none the less important to demonstrate how sensitive the development of the contribution rate is in regard to changes in the underlying assumptions. In doing so, the target value for the sustainability reserve fund, which should be in a corridor between 20 percent and 150 percent of one month's expenditure, has to be accounted for.

76. For the middle variant, the 2005 pension insurance report shows a contribution rate of 19.4 percent in 2019. Analysing the effects of different wage assumptions for 2019, it is noticeable that the differences between the middle and the upper wage variant are small as regards the effect on the contribution rate. The range in the contribution rate dependent on the wage assumptions for 2019 turns out to be highest at 1.4 percentage points at the lower path of the employment development and proves to be lowest at 0.8 percentage points using the higher path of the employment development. This affects the setting of the upper contribution limit of 20.0 percent until 2020. In the lower variant of the wage development and with a low or

middle employment development at the same time the contribution rate is above 20.0 percent in the year 2019. In total the 20 percent limit is exceeded in four out of nine variants, at least temporarily.

77. When varying employment levels, the effect on the contribution rate tends to be less pronounced. If in the year 2019, the employment path within a wage path is changed either upwards or downwards the contribution rate changes in the lower wage variant by 1.2 percentage points, in the middle variant by 0.8 percentage points and in the higher variant by 0.4 percentage points.

78. In case the contribution rate in the middle variant exceeds the 20 percent limit before 2020, the federal government will have to submit proposals to the legislative bodies to ensure that the contribution rate remains below 20 percent. The 2005 pension insurance report does not feature a contribution rate above 20 percent in the middle variant until 2019. Moreover, in the year 2019 a contribution rate of 19.4 percent means that the contribution rate does not exceed its limit.

79. In addition, the gross pension level in the Statutory Pension Insurance should not fall below 46 percent. According to the middle variant, the pension level in 2019 is 46.3 percent.

XIII. The 2005 Old-Age Security Report

80. As well as the pension insurance report, which is presented before November 30th each year, the federal government is also committed in each legislative period to producing an old-age security report that analyses the

income situation of those over 65 (Section 154 Subsection 2, Social Code VI). This means that, in addition to the income from the state-financed old-age security system, occupational and personal pension schemes are supposed to be examined. In addition, the up-take of such schemes as well as the effects produced by the gradual change towards deferred taxation of contributions and pensions are analysed. The federal government has now presented its third Old-Age Security Report, following those produced in 1997 and 2001.

81. The 2005 Old-Age Security Report contains five parts. Part A shows the benefits paid by old-age security systems which are partially or fully funded by the state. Part B contains the same old-age security benefits seen from the point of view of their recipients. In part C other additional income types are considered. The tax breaks and the up-take of occupational and personal pension schemes are documented in part D. Finally, in part E model calculations on the development of the value of the pension level as a whole can be found. This total pension level consists of the federal pension, the Riester pension and entitlements accumulated through savings based on the exemption from tax of pension contributions for personal retirement provision. The amount exempt from tax increases year on year until 2025. Parts D and E are new additions to the old-age security report.

82. The federal government avoids either making political statements or giving value judgments throughout the whole old-age security report. This also holds true for the part in which the extent of the up-take of occupational and personal pension schemes is discussed. This is despite the fact that, according to the coalition agreement of November 11th, 2005, by 2007 an analysis of the “level of up-take of occupational and personal pensions and

of the extent of its further development" should be made. The findings must show whether subsidies through current instruments have achieved a high-enough up-take of additional old-age provisions. If this has not happened, measures to achieve this have to be agreed upon.

83. The GSAC would have welcomed an initial political assessment examining the up-take of state-subsidised additional pension schemes being made within the framework of the old-age security report as presented. The GSAC, therefore, recommends that criteria are developed – if necessary in cooperation with the GSAC – to establish whether occupational and personal pension schemes have been taken up in sufficient numbers to ensure that an assessment according the requirements can be made.

84. The structure of parts A to C was taken from the previous old-age security reports. A positive benefit is that the outline, compared to previous reports, is clearer and therefore more easily readable. For example, old-age pension schemes in Part A are presented divided into "insured and beneficiaries", "benefits and expenditures" as well as "financing and revenue".

85. As regards part A "Benefits and financing of the full or partial public funded old-age pension schemes in Germany", the GSAC suggests changing the underlying legal stipulation of Section 154 Subsection 2 Clause 1, Social Code VI, to expand its application to all compulsory old-age pension schemes governed by public law. This means that in part A all compulsory pension schemes subject to public law and the partial or completely publicly financed pension schemes should be analysed. This would mean that pension schemes organised by professional associations in particular could also be

analysed in part A. Professional associations are responsible for compulsory old-age provisions for those employed in so-called “free” professions (e.g. doctors, lawyers, architects). Such associations are usually assigned to the first pillar of the old-age security system, as is the federal pension insurance scheme.

86. In part C “The total income in old-age”, the term “income” has been expanded to include all types of disposable income. This accounts for the kinds of income that secure against the biometric risk of longevity, such as, for example, payments from personal pension schemes or from life insurance schemes as long as these are paid in the form of an annuity. In addition, types of income that have no predetermined duration, such income from employment, are also taken into account. However, in part C a central methodical problem arises since not all forms of personal wealth accumulation that ultimately could also serve as a retirement provision, are included. Only those income streams that are intended to produce a continuous income from accumulated capital are considered, rather than general capital that can be converted into income in old age – even if this conversion is possibly planned. Under this is included both accumulated finance capital as well as property. Compiling data on the – actual or potential – consumption of pensioners’ wealth would aid the creation of a more comprehensive picture of their economic situation. Nevertheless, given that the distribution of wealth is considerably more uneven than distribution of income, it is undeniable that wealth consumption is not a general substitute for benefits from state-run old-age security systems.

The fact that this aspect should not be dismissed is clearly demonstrated by the capital-funded life insurance schemes (which are not considered in the

report). The benefits paid out by the life insurance schemes – excluding *Pensionskassen* and *Pensionsfonds*[2] – totalled 52 billion Euros in 2003 and about 51 billion Euros in 2004. This corresponds to about a quarter (26.8 percent and 26.2 percent respectively) of pension expenditures of the statutory pension insurance for both blue- and white-collar workers. Such monies can provide an income in old-age. Moreover, property — its value either realised privately or rather the money saved through "unpaid rent" — is not included as income in part C of the old-age security report. This corresponds to the old-age security report's system of classification of pure property value, but it only makes sense if one assumes that the property is not sold during the insured person's lifetime. However, the fact that the value of rent saved when case the property is used by its owner is not considered does not fit into the report's system of classification since rental income is taken into account.

87. In part D "Tax breaks and the up-take of the occupational and personal pension schemes", it is mentioned that according to the latest available data 5.6 million contracts for Riester pensions have been taken out. Following rapid growth, with 3.4 million contracts issued by the end of 2002, uptake of this subsidised personal pension scheme had stagnated by the end of 2004. Legislative measures have again led to an increase in the numbers of Riester pensions being taken out in 2005. These include the simplification of the subsidy procedure as well as the change to unisex tariffs for Riester pensions

[2] *Pensionsfonds:* A relatively new tax-qualified vehicle. A separate legal entity that provides benefits or administers a DC pension plan on behalf of the company. Employees have a direct claim against the *Pensionsfonds.*
Pensionskasse: A special insurance company established by a company or several companies to serve exclusively the employees of those companies. Beneficiaries have a claim against the *Pensionskasse.*

taken out after December 31st, 2005. Because of the associated contribution increase for men without any alteration in the extent of benefits available it is likely that the introduction of unisex tariffs created a rush to buy Riester pensions before the changes came into force.

88. According to the statutory duty laid down in Section 154 Subsection 2 No 4, Social Code VI with regards to the personal old-age provision, the old-age security report includes only statements on the up-take of tax breaks in regard to the Riester pension under Section 10a and Part XI of the Income Tax Law. In the opinion of the GSAC, a change in legal regulations should be made to guarantee that in future the old-age security report also shows the up-take of personal life annuities according to Section 10, Subsection 1 No 2b, Income Tax Law.

89. Occupational pension provision financed by employees has grown in scope considerably since its introduction in 2002. The newly introduced entitlement (Section 1a, Act to Improve the Occupational Pension Schemes, *Gesetz zur Verbesserung der betrieblichen Altersversorgung*), which allows earnings up to 4 percent of the contribution assessment limit in the Statutory Pension Insurance to be exempt from tax and social insurance contributions and can be used to accumulate an occupational pension, has made a considerable contribution to this development. The remuneration conversion exempt from tax and social insurance contributions has led to many employees previously not covered by an occupational pension scheme taking out a supplementary capital-funded pension plan. The exemption from social insurance contributions, however, is only valid until December 31st, 2008. After this point, the above-mentioned earnings are then liable to social insurance contributions. This poses problems as then health and long-term

care insurance contributions have to be paid on contributions made during one's working life as well from any occupational pensions resulting from these contributions. This "double-liability" for contributions may be in line with constitutional law, but it proves a disincentive whose effect can already be seen now. It weakens the competitiveness of occupational pension plans financed by employees compared to personal private pension schemes.

90. As a consequence of the "double-liability" for contributions, the remuneration conversion used as a means of financing occupational pension plans funded by the employees could become unattractive for many employees. This would have far reaching consequences for additional capital-funded old-age provision. In the best case, the employees would switch from personal pension plans to, for example, the Riester pension. Such a switch could give rise to potential disadvantages for employees if they lose out on cost and efficiency advantages of a collective transaction in an occupational pension schemes as compared to an individual private pension plan.

91. An alternative for employees is to limit their payments into additional capital-funded pension plans and instead expand their present consumption. In addition, one has to assume that those concerned will try to find other old-age security provision. One possibility already exists today in form of working time accounts that are designed for the long-term. In old age these accounts allow a form of partial retirement. This would contradict the federal government's objective of increasing working life.

92. Finally, the scale of lost contributions to the health and long-term care insurance through remuneration conversion within the occupational pension

schemes have yet to be properly assessed. According to estimates by the federal government, both branches of the social insurance lose about 300 million Euros per annum because of remuneration conversions exempt from social insurance contributions. This corresponds to only two-tenths of a percent of the total contribution income of these two branches of social insurance. Furthermore, against this loss in contribution one must contrast the additional income arising from benefits that are liable to contributions paid from occupational pension schemes financed through remuneration conversion.

93. The fact that the “double-liability” (planned from December 31st, 2008) of contributions as well as of benefits from occupational pension schemes financed by the employees only concerns health and long-term care insurance schemes provides grounds to object to maintaining the contribution exemption for remuneration conversion for occupational pension schemes in its present form. In pension and unemployment insurance schemes, however, there would be a tax burden only during the contribution period. But this burden would lead to higher benefit entitlements as the equivalence principle applies to these branches of the social insurance system. For this reason liability for contributions as regards the remuneration conversion limited to the pension and unemployment insurance could be considered. Provided that occupational pensions that are based on remuneration conversion are exempt from contributions to the health and long-term care insurance, then a difference in the burden arises only from the “initial liability” under the remuneration conversion compared to the “deferred liability” under occupational pension schemes financed by the employer.

94. The GSAC does not underestimate the fact that the contribution exemption under the remuneration conversion aimed at subsidising occupational old-age provision is burdened with problems. By which is meant the preferential treatment accorded to the second, capital-funded, pillar of old-age provision that adversely affects the financial basis of the pay-as-you-go financed social insurance schemes. But since creating and developing capital-funded supplementary systems in old-age security in general and in the occupational pension schemes in particular is of central importance for future security in old-age, the GSAC argues unanimously to prolong the provision for remuneration conversion exempt from social insurance contribution beyond December 31st, 2008 until a substitute through a new – more systematic – subsidy mechanism is put into effect. The aim should be to subsidise the Riester pension and the occupational pension along the same principles and to strengthen their respective attractiveness. In addition, the GSAC suggests subsidy limits under the Riester pension and under the occupational pension schemes (4 percent of the contribution assessment limit in the Statutory Pension Insurance) be brought in line and – against this background that working biographies become increasingly less standardised – so that the pool of beneficiaries is expanded to include all employees.

95. Within the framework of part D, for the first time those employees liable for social insurance contribution who have not yet taken out a subsidised additional old-age pension were surveyed regarding their reasons for not taking out a state-subsidised old-age pension. One answer was dominant in all evaluation methods: “I do not trust the state or the government, the laws are changed too often.” Other reasons such as complicated systems,

administrative costs or a too low an income came second to this answer. This can be seen as an indication of the need for a trustworthy policy guaranteeing a stable general framework. An unstable policy subject to changes in direction or one that requires repeated subsequent amending entails a loss of trust.

96. In part E “Development of the total pension level”, the model calculations presented show that the reduced pension level in the Statutory Pension Insurance resulting from legislative measures already passed can be compensated for by building up the state-subsidised old-age pension scheme. For this, according to the model assumptions, a Riester pension is taken out and is permanently endowed with 4 percent of the respective earned income. In addition, it is assumed that the tax savings resulting from the change to deferred taxation on contributions and pensions is paid into a personal pension scheme up to the maximum extent allowed.

97. According to the model calculation in the case of an average earner with 45 contribution years (the standard pensioner), the gross total pension level for each cohort entering retirement declines temporarily by about two percentage points to 46.3 percent then rises again in the long-term. But later retirement cohorts will no longer achieve the present level. However when looking at the net total pension level, after a decline in the medium term it exceeds the present level for retirement cohorts from 2030 onwards. A similar development results for a low-income earner whose income is 2/3 of the average income. Here the gross total pension level also shows an initial decline before it rises again, though similarly it does not reach the present pension level. As regards the net total pension level, the model calculation shows a considerably higher level than today for cohorts retiring in 2020 and

beyond. The total pension level of a representative high earner whose income is 1/3 above average earnings shows a significantly different development. In this case, the gross total pension level rises above the present level in the long-term while future retirement cohorts face a considerably lower net total pension level. With this, the effect of the progressive income tax tariff that levels out the net income is shown. In the future this effect is also felt by pensioners.

98. The model calculations turn out to be considerably more positive with regards to the decline in compensation in pension level in the Statutory Pension Insurance if child-rearing periods and other consideration periods are taken into account. Married couples where the wife has an interrupted or uninterrupted working life as well as single parents in employment can achieve in the cases presented here a considerably higher gross as well as net total pension level if they belong to the younger cohorts.

99. The GSAC points out that the calculations in part E are intended to illustrate the means by which the future pension level decline in the Statutory Pension Insurance can be compensated for by an additional old-age pension scheme and the extent to which this can be achieved. Such calculations, however, cannot be interpreted as prognoses for a future pension level.

100. As regards the results from the model calculations in part E, the GSAC takes the view that a distinction should be made between three effects concerning the total pension level. Firstly, the effects of the additional old-age pension on the total pension level; secondly, the effects resulting from

deferred taxation; and thirdly, the effects resulting from an improved consideration of child-rearing periods in the Statutory Pension Insurance.

101. In the model cases analysed, biographical special characteristics play an important role. Those without children are assumed to be employed continuously for 45 years; a figure of 39 years in general for persons with children. Numerous analyses on working lives and working careers show that such assumptions are not realistic and given the general framework, this is especially true for future years. This is true for the model case of the "low-income earner" in particular. This type rarely exists in reality. The GSAC does not underestimate the difficulty of developing typical cases, but nevertheless thinks it is necessary to design more realistic examples in cooperation with the GSAC for the next old-age security report.

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