Germany

Germany: Pension system in 2020

The statutory public pension system has a single tier and is an earnings related PAYG system. Calculation of pensions is based on pension points. If individual old-age provision from all income sources is not sufficient, additional means-tested benefits are available.

Key indicators: Germany

		Germany	OECD
Average worker earnings (AW)	EUR	52 104	34 301
	USD	59 513	39 178
Public pension spending	% of GDP	10.2	7.7
Life expectancy	at birth	81.1	80.6
	at age 65	19.8	19.7
Population over age 65	% of working- age population	36.5	30.4

Qualifying conditions

At present the regular old-age pension is payable from age 65 and nine / ten months (depending on the pensioner's year of birth) with at least five years' contributions. Less than five years' contributions earn no benefit. The statutory retirement age is gradually increasing and for those born in 1964 or later, the statutory retirement age will be 67. A special length of service pension is paid with 45 years of contribution at age 65 for those born 1964 or later.

Benefit calculation

Earnings-related

A year's contribution at the average earnings of contributors earns one pension point. The relevant average earning is approximately identical to the National Accounts average earnings. The relevant earnings were EUR 40 551 in 2020. Contributions based on lower or higher income earn proportionately less or more pension points. Contributions are levied on annual earnings up to EUR 82 800 in 2020.

At retirement, the pension points of every year are summed. To calculate the amount of the yearly pension the sum of pension points is then multiplied by an annual "pension-point value", which was EUR 410.28 in 2018. The pension point value is valid for newly retired and already retired pensioners. The pension point value is adjusted annually in relation to the gross wage growth as a starting point. In addition, the "contribution factor" accounts for changes of the contribution rate to the statutory pension scheme and to the subsidised (voluntary) private pension schemes. An increase of contribution rates will reduce the adjustment of the pension point value. The "sustainability factor", that measures the change of the number of standardised contributors in relation to the number of standardised pensioners, links the adjustment of the pension point value to the changes in the statutory pension scheme's dependency ratio, the ratio of pensioners to contributors. These two factors in the indexation formula can alter the size of adjustment, resulting in a gradually slower growth of the pension point value in relation to gross wages per capita in the long run.

The relevant average earnings for calculating the pension points as well as the pension-point value are slightly different for East German pensions. In 2017, a law concerning the alignment of East German pension values to West German levels was legislated. The East German pension value will reach the West German value by 2024. Thereafter there will be no differences in pension regulations.

Supplement for low-income pensioners

In January 2021, Germany introduced an income-related pension supplement (*Grundrente*) to those who have made compulsory contributions to the statutory pension insurance for at least 33 years on the basis of relatively low earnings throughout the whole working life. The number of points earned are doubled, but only to a maximum of 0.8 per year (corresponding to 80% of the average income) for a maximum of 35 years. Only contribution periods with average earnings points of at least 0.025 per month (corresponding to 30% of the average income) are eligible. The full amount of the supplement is paid to pensioners with monthly relevant income (including salary, pensions, rental income, etc.) of up to EUR 1 250 for a single person or EUR 1 950 for a couple. With monthly relevant income above these amounts but not exceeding EUR 1 600 for a single person or EUR 2 300 for a couple, the supplement is reduced by 60% of monthly income above EUR 1 250 or EUR 1 950, respectively. No supplement is paid with monthly income greater than EUR 1 600 for a single person or EUR 2 300 for a couple.

Social assistance

If individual old-age provision from all income sources is not sufficient, additional means-tested benefits can be claimed from social assistance. Those benefits refer to the individual primary needs. Means-tested provision results as the difference between the individual need and the respective household income (including pension benefits). The average of these needs amounts to EUR 9 732 per capita in 2019 for all, who received means-tested old-age provision.

Voluntary private pensions

There is an additional voluntary private pension which can be provided by banks, insurance companies or investment funds (so-called Riester pension). Riester pension is tax-promoted and subsidised by the government. The modelling assumes a contribution rate of 4%.

Variant careers

Early retirement

Early retirement is possible at the age of 63 for persons with an insurance record of at least 35 years. However, the pension benefit will be reduced by a permanent deduction, which increases in line with the rise of the statutory retirement age. If retiring before the statutory retirement age (age of 67 for those born 1964 or later), benefits are permanently reduced by 3.6% for each year pensioner's fall short of the statutory retirement age. In addition, retiring at age 63 compared to someone retiring at 67, pension entitlements are significantly lower due to working four years fewer and not earning additional pension points.

Individuals can still retire at the age 63 without any pension penalties if they complete 45 years of insured time (employment, child care or from child-raising periods up to age 10 or periods of short-time unemployment (UB1) all count as insured time). Unemployment spells at the ages 61 or 62 do not count. Beginning in 2016 this age is increasing until it reaches 65 for those born 1964 or later. At present, early retirement is possible from age 63 and four/ six months.

Late retirement

Postponing the retirement age will yield a higher pension accrual of 0.5% for each month worked after the statutory retirement age.

Childcare

For children born in 1992 or later one parent is credited for a period of three years with one pension point per year (equal to contributions based on average earnings). For children born before 1992 two pension points are credited. These entitlements are given to employed as well as non-employed parents and can be split between parents. Those child related benefits in the public pension system are tax-financed. There are also credits for periods caring for children up to age 10. These years are considered as qualifying periods for a pension ("*Berücksichtigungszeit*") and in addition have an effect on the pension entitlement. If people work while having at least one child below age 10, or if two or more children below the age of ten are parented (without working requirement), their pension entitlement for this period will be increased by 50 percent. The bonus cannot exceed 0.33 pension points per year. However, overall the total accrual may not exceed one pension point per year.

Unemployment

The unemployment insurance contributes to the pension scheme on behalf of the unemployed. During the first period of unemployment benefits (UB1, "*Arbeitslosengeld I"*), contributions are paid on the basis of 80% of previous gross earnings. The first period lasts between 6 and 24 months depending on both age and contribution years. Thereafter, the unemployed person moves to the second type of unemployment benefit (UB2, "*Arbeitslosengeld II"*), which is means-tested and paid at a lower rate. For this period, the unemployment insurance provides no financial contributions to the pension scheme.

Self-employed

With exemption for some occupations, the self-employed are not compulsorily covered by any earning-related pension scheme

Personal income tax and social security contributions

Taxation of pensioners

There is no special relief for older people (specifically). Income up to a statutory line (*"Grundfreibetrag"*) is exempt from tax. This is EUR 9 408 per single person in 2020. This provision applies equally to citizens of pension age and those of working age.

Taxation of pension income

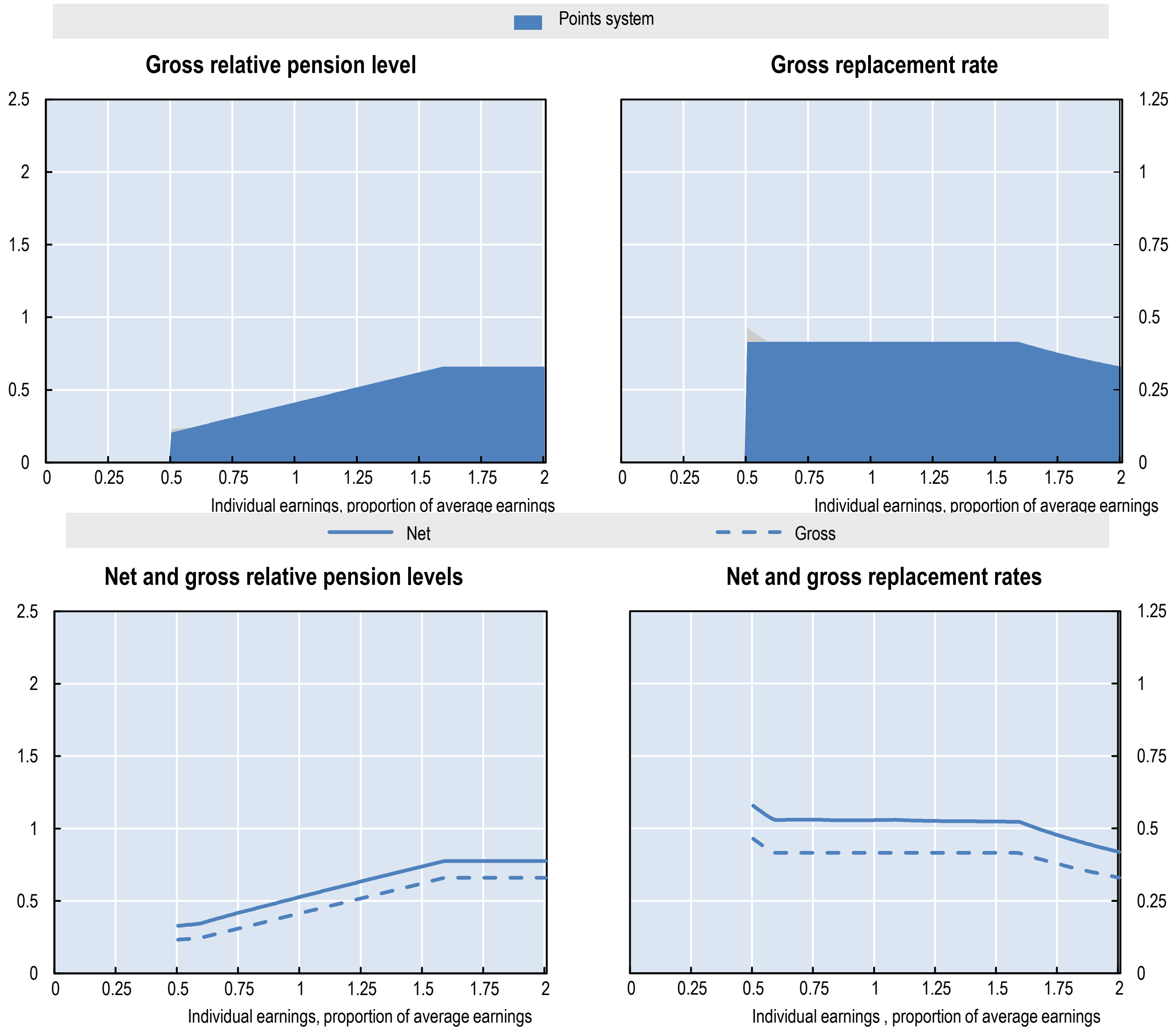
The tax regime is changing from a TTE into an EET system. The proportion of the income subject to tax varies with the year of retirement at which the individual first started drawing the pension. In 2020, 80% of the pension is taxable. From 2020 until 2040 the taxable part of the pension will increase by one percentage point per year.

There are additional tax exemptions summing up to EUR 138 for pensions drawn at any age. In addition contributions to health and long term care insurances allowing for services comparable to the provisions of the statutory health and long term care insurance are tax exempt from the taxable income. For pensioners, these contributions are usually entirely tax exempt.

Social security contributions paid by pensioners

Pensioners pay social security contributions on pension income to the health care system (8.3% in 2018) and to the long-term care system (2.55% in 2018). However, pensioners do not pay contributions to pension scheme and unemployment insurance.

Pension modelling results: Germany in 2065 retirement at age 67



Men	Individual earnings, multiple of average					
Women (where different)	0.5	0.75	1	1.5	2	3
Gross relative pension level	23.2	31.2	41.5	62.3	66.0	66.0
(% average gross earnings)						
Net relative pension level	32.9	42.0	52.9	74.0	77.6	77.6
(% net average earnings)						
Gross replacement rate	46.5	41.5	41.5	41.5	33.0	22.0
(% individual gross earnings)						
Net replacement rate	57.9	53.0	52.9	52.4	41.9	28.2
(% individual net earnings)						
Gross pension wealth	9.3	8.3	8.3	8.3	6.6	4.4
(multiple of individual gross earnings)	*10.3*	*9.2*	*9.2*	*9.2*	*7.3*	*4.9*
Net pension wealth	11.6	10.6	10.6	10.5	8.4	5.6
(multiple of individual net earnings)	*12.8*	*11.7*	*11.7*	*11.6*	*9.2*	*6.2*

Assumptions: Real rate of return 3%, real earnings growth 1.25%, inflation 2%, and real discount rate 2%. All systems are modelled and indexed according to what is legislated. Transitional rules apply where relevant. DC conversion rate equal 90%. Labour market entry occurs at age 22 in 2020. Tax system latest available: 2020.