# Problems of Providing Income Security in Old Age Cannot be Solved Merely by Changing the Mode of Financing

The German government is planning concrete measures to scale down, over the longer term, the pay-as-you-go system of old-age provision in favour of pre-funded pensions. The reform will bring two fundamental changes that will affect all those insured persons currently of working age: a reduction in the pension level provided by the statutory pension insurance *(Gesetzliche Rentenversicherung* – GRV) over the longer run, and compensation for the income gaps so created by way of private, voluntary provision (such as Individual Retirement Accounts), supported financially by government.
These measures are intended to be a response to the implications of longer life expectancy and the declining birth rate for the financing of the GRV in the coming decades. The details of the reform have not been decided yet. The scope this decision process implies for shaping policies should be used to implement structural reforms made necessary by changes in working and social life but not yet initiated. If the reform concept is realised in the form currently under discussion, it can be expected, primarily because of the voluntary nature of the individual retirement accounts, to lead to even greater inequality of income, and possibly also poverty, among the elderly.

## The German government's concept for changing the mode of financing the statutory pension insurance system

It is the intention of Federal Government in Germany to expand pre-funded provision for old age in order to ease the pressure on the statutory pension insurance system.[1] The shift away from the pay-as-you-go system in favour of a funded form of financing is to be accompanied by a decline in the pension level provided by the statutory pension insurance. This is based on the belief that it is easier to cope with the consequences for old-age provision of longer life expectancy and declining birth rates if the system is financed partly on a funded basis than if the pay-as-you-go system is retained in pure form.

Under the plan currently under discussion, saving for old age pensions by workers with average and below-average incomes will be subsidised by the government. The level of these government grants is to vary according to the number of children, and is to represent up to about DM 1000 p.a. for a couple with two children, for example. Primarily with taxpayers on higher incomes in mind, this kind of saving will be exempted from tax. Starting in 2001, 0.5% of gross earnings can initially be saved with an entitlement to government financial support; this figure is then to rise in steps, reaching 4% in 2008, creating a stock of assets and thus a pre-funded individual retirement account. This will serve, it is claimed, to strengthen the 'second' and 'third' pillars of old-age provision, i.e. company pension schemes and private pensions. No decision has been taken on the details of the reform, however; there is clearly still scope for making amendments to the proposed reforms.

What is striking is that it is only in a few areas – such as survivors' pensions – that consideration has been given to *structural* reforms. Rather, the reform measures are focused on reducing the pension level for those insured persons entering retirement after 2011. The reduction in the statutory pension will not affect pensions applied for up to and including 2010. However, these pensions have already been reduced by limiting annual pension adjustment to the rate of inflation in 2000 and 2001. Thus, the following discussion is limited primarily to the question of the partial reduction in the pension level in the GRV in favour of expanding pre-funded old-age provision.

Any cut in pension level will cause serious problems. In order to recognise them, it is necessary to recall for a moment the goals of the system of social security in old age in Germany.

## Goals of social security for the elderly

In Germany the main aim of the pension system is to ensure, at an adequate level, the maintenance of all those prevented, for reasons of age or invalidity, from earning their own income. It is often forgotten in the debate on modernising the welfare state that a cheap welfare policy is not necessarily a good welfare policy. The aim must be to achieve existing social policy goals with the use of better instruments than those currently deployed.

[1] Cf. statement by the labour and social affairs minister 'Das Konzept der Rentenreform 2000', Berlin, 11 June 2000.

In economic terms, it is important that the acquisition of claims to financial security in old age do not distort incentives to work. Policy should be based on individual responsibility, but from a social policy perspective it is necessary to provide a minimum entitlement to social security. The German statutory pension insurance system (GRV) is based on the principle of actuarial fairness, and thus has always been conducive to individual responsibility. This means that there is no minimum pension, so that some of the elderly are dependent on means-tested social assistance (*Sozialhilfe*).

The level of social security considered adequate is determined as the outcome of a social discourse. The minimum is the level of support available in other cases, too, i.e. in Germany the level of entitlement to general social assistance. Beyond this, the statutory pension insurance system has also pursued the goal of maintaining the relative position in the earnings distribution during old age *(Lebensstandardsicherung* – maintaining the living standard), because most elderly people have no opportunity of topping up a transfer income through paid employment. If this goal is to be retained, a concrete statement must be made as to the level of social security considered compatible with the goal of 'maintaining living standard'. This concretisation must take the form of the pension level which is guaranteed by GRV. In Germany the statutory pension insurance system has always taken earned income – to be precise, the income subject to social insurance contributions – as the reference variable for the pension level.

Today the statutory pension insurance scheme provides virtually all the social security in old age enjoyed by employees. Pension entitlements are determined primarily by the number of years during which contributions were paid and by the level of gross income, up to a ceiling. The pension level is currently geared to the so-called 'standard pensioner', that is to a fictitious person employed for 45 years with an income estimated by averaging the incomes of all socially insured employees in each year. The policy was to achieve a pension level equivalent to 70% of average net income; the corresponding gross pension level was just under 50%.

However, the level of the standard pension tells little about the actual income positions of the elderly. If the number of insurance years differs from 45, and if earnings differ during the period in employment from the current average, the pension level will not be equal to the standard pension. In reality the level of security provided by the GRV scheme is such that in some instances it does not even meet the minimal target of avoiding poverty among the elderly.

Currently the monthly net standard pension is around DM 2020 in western and DM 1750 in eastern Germany. The actual amounts paid out vary enormously, however, depending on the gender of the insured person, the type of old-age pension, and previous occupation. The lowest average old-age pensions are paid to women. But a not inconsiderable number of men fail to gain entitlement to the standard pension level, even after paying contributions for a full-time job for 45 years, because the insured wage income was below average.

Married insured persons bequeath on their death an entitlement to a widows'/widowers' pension to the surviving partner. The survivor's own pension or earned income is set off against this pension entitlement, however. This recognition of the claim by the surviving partner is based on the old model of the one-earner family: the breadwinner for the family receives wage compensation benefits, the surviving partner 'transfer compensation benefits'.

For as long as this family model applied to large sections of the population, the prevailing form of social security provision was appropriate to the goals set. Yet changes have occurred in recent decades, with more and more women engaging in paid employment. Married women, in particular, increasingly combine child-care and a career in the labour market. The risk of divorce is greater; marriage and child-raising are no longer so closely linked as they were in old days; and many people get married without intending to have children, while others raise children outside marriage, either as single parents or as unmarried couples or in other forms of cohabitation.

Against the background of these changes in social relations and attitudes, particularly in those relating to the division of labour between men and women, it is a declared aim of German pension policy[2] to provide women with an independent – that is independent of the husband and his income – provision in old age within the GRV.

Alongside these changes, there have also been shifts in the conditions of working life. It is no longer realistic to expect workers to have uninterrupted working careers. Studies of working patterns of those insured persons still in working life show that men, too, are increasingly likely to have 'gaps' in their working life. Although unemployment is the main reason for this, people's perceptions of the way they want to lead their lives have also changed. Thus people voluntarily reduce their working hours and/or interrupt their working life, leading to gaps in their provision for old age. The survivors' pensions based on incomplete working biographies are correspondingly low.

---

[2] See, for instance, the resolutions by the two houses of the German parliament, e.g. Deutscher Bundestag, *Drucksache* no. 12/837, 21 June 1991.

Reforms should therefore seek to provide a lasting solution to the problems resulting from social change. Yet the reform efforts currently being made are targeted far too narrowly on the single aspect of financing. This is a serious deficiency.

## Advantages and disadvantages of the different forms of provision

A view widely held in the debate on financing old-age provision is that a fully funded system is superior to the pay-as-you-go system in dealing with the ageing of the population. The DIW has on more than one occasion called this hypothesis into question.[3] It has pointed out, among other things, that benefits under the fully funded system cannot be 'immunised' with sufficient certainty against changes in age structure of the domestic population, even if the insurance funds invest money capital abroad. Given the considerable real and monetary (e.g. exchange-rate) risks in the global economy, no one can guarantee that it will be possible to earn, in the longer run, those rates of return abroad that are no longer considered possible in an ageing domestic economy.

Moreover, what will happen in the longer run when other countries also increasingly encounter the problem of an ageing population and also want to invest abroad the money assets they accumulate for old age pension purposes? There would be fewer and fewer countries willing and able to take on the required debts.

The fundamental truth is that the people living in a given period must live off production during that period. More specifically this means that, if the number of pensioners is growing and their level of social security remains unchanged, pensioners will claim an increased proportion of current output produced. This burden can, however, be eased through economic growth, which means that there is a bigger 'cake' to be divided, and it can to some extent be averted by exporting and subsequently importing capital, but only if the same processes of ageing and economic developments are not occurring simultaneously throughout the world. It is of only secondary importance whether pensioners finance their spending by way of capital yields, running down savings, or pensions based on a pay-as-you-go system. Whatever method is used, subsequent generations have to shoulder a heavier burden, as long as the income level of pensioners remains constant.

Supporters of a fully funded system hope that real growth will receive a boost from the increased formation of monetary assets, because this will in turn induce additional (real) investment. This may prove a vain hope, however. Increased savings also imply a reduction in consumer demand, and reduced sales opportunities will reduce firms' willingness, in spite of the lower rate of interest due to more saving, to use the additional money saved by private households for investment.

The decision by the German government to incorporate pre-funded elements in the system of old-age provision was almost certainly influenced by the claim, frequently heard, that in the longer run the rate of return on capital must, for reasons of principle, be higher than the implicit rate of return earned under the current pay-as-you-go system. If this were the case, then it would indeed have to be considered an important advantage of the funded system. Yet in the recent literature a number of doubts have been expressed as to whether the basis for such a comparison is correct and as to the general postulate that the pre-funded system is superior to the pay-as-you-go system in this respect.[4] Studies of the USA, for instance, have shown that the rate of return is subject to substantial fluctuations even over a long run. This means that for different age-cohort groups the level of security provided in old age could vary substantially for any given savings-to-income ratio.[5]

Model calculations show that, owing to the ageing of the population, the implicit rate of return on the pay-as-you-go pension is less favourable for the average insured person than the pension paid by a well-administered capital fund. At first sight this appears plausible. It seems likely, namely, that it would be advantageous for an average person, one exhibiting no special risks, if he or she were to make private provision. An individual who does not become unemployed or leaves the labour force before the normal retirement age, and is able to find favourable forms of investment on the capital markets, would presumably be able to earn a higher rate of return, if he or she were not obliged to pay into the GRV system, than is currently the case.

---

[3] Cf. Gert G. Wagner, Ellen Kirner, Johannes Leinert and Volker Meinhardt: 'Fully Funded Insurance: No Panacea for Social Security for the Elderly', Economic Bulletin, no. 1, January 1999.

[4] Cf. Peter R. Orszag and Joseph E. Stiglitz, 'Rethinking pension reform: Ten myths about social security systems', presented at the conference New Ideas about Old Age Security, World Bank, Washington D.C., September 14/15, 1999; available on the Internet http://www.worldbank.org/knowledge/chiefecon/conferen/papers/rethinking.htm. See also the literature cited in the previous DIW articles in the Economic Bulletin.

[5] Cf. Gary Burtless, 'Social security privatisation and financial market risk: Lessons from US financial history', *DIW Discussion Paper*, no. 211, Berlin 2000.

Contributions to the current debate all too frequently refrain from weighing up the possibly higher – although riskier – yield from funded systems against the relative security – until now at least – of the pension entitlements under the GRV fund.

Moreover, all arguments in favour of the pre-funded system have a fundamental weakness. They fail to allow for the fact that, in the GRV system, a redistribution of income occurs between members of a single generation; for instance, early retirement pensions are financed within GRV. It must be supposed that in the current debate, many of those arguing for a reduction in the importance of the GRV do so because they are opposed to these redistributive elements that are built into the system.

The factors leading to an element of redistribution within the statutory pension insurance system as it stands, such as allowance for periods in which no contributions are paid and the benefits paid to survivors, would not simply disappear under a fully funded system, but would create a need for tax breaks and/or transfer payments (which of course would create again a burden).

What may be seen as a disadvantage from an individual perspective – the redistribution in favour of those whose claims on the GRV system are not matched by the contributions they have paid in – must be seen as an advantage of the pay-as-you-go procedure from a social policy angle.

What is true is that the pay-as-you-go system entails 'political risks'. For the currently young generation of contribution-payers, the reduction in the pension level has the initial advantage of reducing their obligation in the coming years to finance the pensions of the elderly. This is considered to be a contribution toward greater 'intergenerational equality'. Reducing obligations towards pensioners, in the interests of the young, is one of the reasons why sections of public opinion have found the reform proposal attractive. It seems likely that the costs of the uncertainty about further political interventions in pension legislation are considered to be higher than they were.

If the German government sticks to its intention to strengthen private provision for old age, particular attention needs to be paid to the framework conditions and regulation of (government-supported) private provision models. For irrespective of the way in which the statutory pension insurance scheme develops in detail during the coming years, private provision can be expected to increase in importance; in view of that private provision should be designed in such a way as to pose the minimum risk to the individual.

In dialogue with private firms offering products to provide security in old age (banks and other financial intermediaries, insurance companies), the government should define quality criteria for old-age provision. Good private models[6] should be given a seal of approval. The criteria on which such a seal is based must be developed jointly by government and the private firms concerned.

It must also be examined how the transaction costs incurred moving private savings from one mutual fund or an insurance provider to another fund or insurance company could be limited in such a way as to make such changes a feasible proposition, and thus to enable competition to develop on these markets. In order to do this, it is necessary to ensure that the administrative costs are kept in check.[7]

In particular, government must decide whether it is prepared to accept, within the system of government-supported private provision, the unequal treatment afforded men and women that is usual in this segment of the private insurance market. Currently, unlike the statuory system, private pension insurance schemes require that women pay higher contributions than men, owing to their longer life expectancy. If this is thought undesirable for political reasons, a corresponding legal requirement will have to be introduced. This would certainly be feasible and could also be realised in practice, as private pension insurance companies can cover the 'gender risk' by way of appropriate re-insurance contracts. Yet this raises the problem that men might turn to foreign-based insurance companies. For this reason harmonisation in this area would be desirable at EU level.

## Problematic reduction in the pension level

The government plans to reduce the pension level in the GRV scheme – for new pensions and starting in 2011 – in stages from the current figure of around 70% to, formally, 64%. Given, however, that the reference variable, 'net income', is lowered by subtracting the contributions paid into the private side of the system, the net pension level will fall to an estimated 62% of net income in 2030 on the basis of the current calculation method.[8] This reduction must be seen as problematic, for two reasons:

---

[6] Cf. Jan Walliser, 'Regulation of withdrawals in individual account systems', August 1999 (http://www.worldbank.org/knowledge/chiefecon/conferen/papers/payoutrev.htm).

[7] Cf. Estelle James, James Smalhout and Dimiti Vittas, 'Administrative costs and the organisation of individual account systems: A comparative perspective', September 1999 (http://www.worldbank.org/knowledge/chiefecon/conferen/papers/smalhout.htm).

[8] Under the proposed pension adjustment formula, which has not yet been fixed, the potential contribution to the private insurance scheme is to be allowed for in calculating net wages.

The ad-hoc intervention in pension legislation is likely to further undermine the confidence of contribution-payers that it is worth paying contributions and that the promised benefits from the statutory pension insurance fund will in fact be paid.

The reduction in the pension level brings with it the danger that insured persons on low incomes or with gaps in their working biography are more likely, in old age, to receive a pension that is below or near the relative poverty line.

The current monthly net standard pensions – DM 2020 in west and DM 1750 in east Germany – do not appear excessive, in view of the fact that contributions have been paid for decades (45 years), compared with a figure of around DM 1000 (including the cost of housing rental) for minimum social benefit for a single person (no contribution requirement). Those insured persons earning substantially less than the average wage have a correspondingly lower pension. This is true of a significant proportion of men. As a result, an average pension entitlement of just 88% of the standard pension has been calculated for semi-skilled white-collar employees born between the years 1936 and 1955 (cf. table 1); the corresponding figure for unskilled and semi-skilled blue-collar workers – representing as many as one million male pensioners – is just 83%.[9]

The pension entitlements of women are particularly low. Women workers in western Germany who have paid contributions for around 30 years on the basis of a full-time job can on average expect a pension of around 60% of the standard pension. That is around 80% of what men who have paid contributions for a similar number of years are entitled to. Even today, women are far less likely than men to have an uninterrupted working career, and for this reason on average women receive even lower pensions than suggested by the above figures, reflecting the gaps in their working careers caused by child-care responsibilities.

The number of pensioners in the statutory pension insurance scheme obliged to live on an income not far above the relative poverty line can be expected to increase. This runs counter to the basic policy goal of ensuring that a social insurance system provides income substantially above the level of minimum social benefit. Particularly serious is the fact that this serves to undermine the legitimacy of the system as a whole, because those with reason to believe that their pension entitlement will be below the income level to which they are in any case entitled under minimum social benefit will be unwilling to pay mandatory pension insurance contributions. And it remains unclear how insured persons in the lower groups of the income pyramid are to be in a position to build up an adequate private pension entitlement.

[9] Cf. Table 1, which is based on data for 1996. In that year the net standard pension in west Germany was DM 1937.

## Offsetting gaps in income security through voluntary private provision?

The German government is relying on the yields from individual retirement accounts to offset the reduction in the pension level in the statutory pension insurance scheme. Originally, the federal ministry responsible for the reform had proposed a compulsory private scheme. Now – after a heated public discussion about more freedom of choice – the same aim shall be reached by way of measures to support voluntary capital investment geared to generating an income in old age. It must be doubted whether this will prove successful.

Persons on low incomes can be expected to be unwilling to take advantage of the measures to support saving, wishing, or being obliged, to utilise their disposable income to cover their current living expenses.[10] Saving is generally positively correlated with the level of income. Thus it is to be expected that those persons in a more favourable financial position will be more likely to claim the planned support for savings than recipients of low incomes. This would change income distribution in old age within this groups in a non-intended manner.

Given that high income people already save a not inconsiderable proportion of their income in order not to be entirely dependent on the GRV pensions in old age, it must be expected that the forms of financial investment practised until now will be at least partially replaced by the forms enjoying government support, i.e. there will be a restructuring of investment portfolios.

The plans for a voluntary pre-funded scheme to provide income in old age pay inadequate attention to the goal of providing an independent income in old age for women, i.e. independent of the husband and his income. Married women have far lower independent pension entitlements in the GRV than other categories of women. These gaps in provision, resulting from the traditional division of labour within the marriage, will clearly not be offset by voluntary capital investment by the couple with the aim of providing an independent pre-funded income for the wife in old age. The results of analyses of a large sample of persons in the GRV scheme indicate that on average married women are less likely to make private provision (pension insurance, life insurance) than men, and when they do it is at a lower level (cf.

[10] For instance, a study conducted on the basis of the socio-economic panel found that single parents with young children had a savings-to-income ratio of virtually zero.

Table 1

## Men and Women Born between 1936 and 1955 Entitled to/Getting an Old Age Pension from the Statutory Pension Insurance (GRV) System in Germany, 1996

Number (extrapolated) and projected[1] income at age 65

| | Men | | | | Women | | | |
|---|---|---|---|---|---|---|---|---|
| | Pensions | | Monthly income (DM) | | Pensions | | Monthly income (DM) | |
| | 1000s | in % | Amount GRV pension | Personal net income in old age | 1000s | in % | Amount GRV pension | Personal net income in old age |
| | | | | **Western Germany** | | | | |
| Total | 7.312 | 100.0 | 1.939 | 2.618 | 7.054 | 100.0 | 964 | 1.245 |
| Of which: | | | | | | | | |
| ...with GRV insurance years[2] | | | | | | | | |
| from 1 to less than 5 years | - | - | - | - | - | - | - | - |
| from 5 to less than 15 years | 332 | 4.5 | 273 | 2.741 | 330 | 4.7 | 197 | 689 |
| from 15 to less than 25 years | 458 | 6.3 | 644 | 1.948 | 1.306 | 18.5 | 343 | 536 |
| from 25 to less than 35 years | 490 | 6.7 | 1.079 | 1.794 | 1.240 | 17.6 | 591 | 787 |
| from 35 to less than 45 years | 1.428 | 19.5 | 1.768 | 2.350 | 1.820 | 25.8 | 1.085 | 1.368 |
| 45 years and more | 4.603 | 63.0 | 2.332 | 2.847 | 2.359 | 33.4 | 1.519 | 1.862 |
| ... with exclusively GRV covered full-time working years | | | | | | | | |
| Total | 7.235 | 98.9 | 1.946 | 2.617 | 2.192 | 31.1 | 483 | 708 |
| Of which: | | | | | | | | |
| from 25 to less than 35 years | 772 | 10.6 | 1.490 | 1.980 | 128 | 1.8 | 1.162 | 1.303 |
| from 35 to less than 45 years | 2.359 | 32.3 | 2.141 | 2.716 | 24 | 0.3 | / | / |
| 45 years and more | 2.851 | 39.0 | 2.458 | 2.993 | - | - | - | - |
| ... with current/last occupational position as | | | | | | | | |
| Blue-collar, total | 3.861 | 52.8 | 1.946 | 2.267 | 2.478 | 35.1 | 756 | 946 |
| Unskilled, semi-skilled | 1.043 | 14.3 | 1.608 | 1.849 | 1.900 | 26.9 | 766 | 946 |
| Skilled, apprentice | 2.596 | 35.5 | 2.060 | 2.409 | 567 | 8.0 | 722 | 940 |
| *Meister*, foreman/women | 223 | 3.0 | 2.196 | 2.562 | 11 | 0.1 | / | / |
| White-collar, total | 2.451 | 33.5 | 2.418 | 3.260 | 4.092 | 58.0 | 1.141 | 1.428 |
| Unskilled, semi-skilled | 31 | 0.4 | 1 352 | 1 699 | 260 | 3.7 | 783 | 953 |
| Low-level skilled | 166 | 2.3 | 1.711 | 2.044 | 1.067 | 15.1 | 825 | 1.034 |
| Medium-level skilled | 1.008 | 13.8 | 2.375 | 2.971 | 2.144 | 30.4 | 1.210 | 1.510 |
| High-level skilled | 608 | 8.3 | 2.335 | 3.407 | 435 | 6.2 | 1.514 | 1.858 |
| Executive | 639 | 8.7 | 2.608 | 3.967 | 186 | 2.6 | 1.795 | 2.413 |
| | | | | **Eastern Germany** | | | | |
| Total | 2.072 | 100.0 | 1.424 | 1.668 | 2.080 | 100.0 | 1.113 | 1.322 |
| Of which: | | | | | | | | |
| ...with GRV insurance years[2] | | | | | | | | |
| from 1 to less than 5 years | - | - | - | - | - | - | - | - |
| from 5 to less than 15 years | 2 | 0.1 | / | / | 1 | 0.0 | / | / |
| from 15 to less than 25 years | 44 | 2.1 | 516 | 1.684 | 46 | 2.2 | 439 | 1.299 |
| from 25 to less than 35 years | 97 | 4.7 | 869 | 1.631 | 173 | 8.3 | 622 | 750 |
| from 35 to less than 45 years | 534 | 25.8 | 1.246 | 1.490 | 618 | 29.7 | 980 | 1.159 |
| 45 years and above | 1.395 | 67.3 | 1.561 | 1.736 | 1.243 | 59.8 | 1.272 | 1.482 |
| ...with exclusively GRV covered full-time working years | | | | | | | | |
| Total | 2.069 | 99.9 | 1.424 | 1.668 | 423 | 20.3 | 879 | 1.132 |
| Of which: | | | | | | | | |
| from 25 to less than 35 years | 283 | 13.7 | 1.097 | 1.466 | 205 | 9.8 | 986 | 1.102 |
| from 35 to less than 45 years | 962 | 46.4 | 1.457 | 1.631 | 62 | 3.0 | 1.132 | 1.713 |
| 45 years and above | 684 | 33.0 | 1.654 | - | - | - | - | - |
| ... with current/last occupational position as | | | | | | | | |
| Blue-collar, total | 1.146 | 55.3 | 1.455 | 1.585 | 686 | 33.0 | 991 | 1.179 |
| Unskilled, semi-skilled | 172 | 8.3 | 1.307 | 1.415 | 303 | 14.6 | 939 | 1.188 |
| Skilled, apprentice | 887 | 42.8 | 1.472 | 1.607 | 375 | 18.0 | 1.033 | 1.174 |
| *Meister*, foreman/women | 87 | 4.2 | 1.569 | 1.698 | 8 | 0.4 | / | / |
| White-collar, total | 734 | 35.4 | 1.491 | 1.744 | 1.305 | 62.7 | 1.198 | 1.384 |
| Unskilled, semi-skilled | 8 | 0.4 | / | / | 57 | 2.8 | 950 | 1.130 |
| Low-level skilled | 86 | 4.2 | 1.364 | 1.524 | 400 | 19.2 | 1.029 | 1.146 |
| Medium-level skilled | 321 | 15.5 | 1.444 | 1.617 | 647 | 31.1 | 1.254 | 1.452 |
| High-level skilled | 136 | 6.6 | 1.566 | 1.925 | 126 | 6.0 | 1.395 | 1.662 |
| Executive | 182 | 8.8 | 1.587 | 1.951 | 74 | 3.6 | 1.485 | 1.795 |

Key: - no figures; /: not listed due to small number of cases, so that figure is statistically insignificant; *: figure with weak statistical significance.

1 Microsimulation on the basis of the legal provisions and income variables prevailining in 1996. — 2 Sum of the months of each category, at least 1 year between the ages of 14 and 65.

Source: Klaus Kortmann and Christoph Schatz, *Altersvorsorge in Deutschland 1996 (AVID '96). Lebensverläufe und künftige Einkommen im Alter*, published by the Verband Deutscher Rentenversicherungsträger (Association of GRV funds) and the Federal Ministry of Labour and Social Affairs, Munich 1999.

table 2). It is as yet unclear how the German government intends to ensure that an appropriate proportion of the pre-funded old-age provision of married employed men is credited to their non-working wives in the form of an independent pension claim.

All in all, if additional saving for all groups of the insured population is considered desirable with a view to offsetting the reduction in the pay-as-you-go pension and easing the burden of contributions in the future, then saving (capital accumulation) must be made compulsory.[11]

## Supplementary reform measures

The following measures would need to be implemented in order to ensure that social and economic changes are reflected in the system of income security in old age in Germany[12]:

– incorporating the entire population in the pay-as-you-go statutory pension insurance scheme
– the obligation to pay a minimum contribution into the GRV and – if the pay-as-you-go pension level is to be reduced – for the private supplementary pension (individual retirement account)

Providing a minimum level of security in old age is a goal that is widely accepted. Currently this goal is met by the provision of social assistance (*Sozialhilfe*). A better solution, however, would be a minimum provision that is financed by minimum contributions under a social insurance scheme like GRV. The obligation to pay a minimum contribution make sure that the goal of avoiding poverty in old age will be reached for evereyone even for those with gaps in paid employment.

The obligation to pay a minimum contribution would also change the basis on which, under the current system, a survivor's pension is granted to the widow or widower. If each person has his or her own, uninterrupted insurance period, and is thus entitled to a minimum income, then the claim to maintenance of the surviving spouse can be covered by the claims earned jointly by the married couple, e.g. by means of an 'earnings sharing' scheme.

Above and beyond the measures to ensure a minimum level of security for non-employed married partners, there is an urgent need to reform the system of survivors' pensions. For young people just entering marriage, the system of widow(er)s' pensions, which is no longer appropriate to modern life styles should be changed. It should be seriously considered whether the survivors' risk should be left to provision; this would have to be compulsory up to a certain level, however.

If it is still considered a desirable policy aim to maintain living standards in old age, then it makes sense to move away from earned income as the basis for calculating entitlement. Increasingly incomes are determined, alongside earned income, by capital yields. To this extent, this income, too, should be covered by GRV, the statutory pension scheme in Germany.

## Conclusion

The problems the German pension system is facing as a result of demographic changes cannot be solved merely by changing the mode of financing. Firstly, it is uncertain to what extent the introduction of the pre-funded scheme would lead to increased aggregate saving. Secondly, it is doubtful whether, given the fact that the German capital market is deeply embedded in the international capital market, an increase in savings would lead to a perceptible fall in interest rates which would be necessary for stimulating investment and thus economic growth. It is very likely, on the other hand, that in the short run an increase of savings and thus a fall in the demand for consumer goods would be damaging to sales expectations, exerting a dampening effect on investment. Consequently, the introduction of the pre-funded scheme would have to be flanked by growth-stimulating measures.

In terms of a cautious evaluation, therefore, the extension of the pre-funded pensions within the system of old-age provision should primarily be seen as a measure that improves the diversification of risks from an individual perspective, while at the same time it needs to be emphasised that increasing the funded component will not necessarily reduce the burden of providing income to the elderly in future.

It is not advisable to implement a general cut in the level of pensions provided by the GRV scheme, without an mandated additional component. Because the GRV makes no provision for a minimum income in old age, the government plan would increase the risk that persons on low income receive an inadequate income in old age, although having paid in contributions for many years. Targeted government subsidies for saving could reduce this risk, but would not remove it entirely; moreover, it can only do so if government spends significant sums in providing support to persons on low earned income. If, in addition, the common social policy aims

[11] The problems associated with this are discussed in Kai A. Konrad and Gert G. Wagner, 'Reform of the public pension system in Germany', *DIW Discussion Paper*, no. 200, 1999, pp. 205 ff.

[12] It is not possible to consider in this report all the pension reform issues that are currently under discussion.

Table 2

## Men and Women Born between 1936 and 1955 Entitled to/Getting an Old AgePension from the Statutory Pension Insurance (GRV) System in Germany, 1996

Number and income[1] at age 65, by family status in 1996

| | Total | Men | | | | | Women | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Total | Married | Living alone | | | Total | Married | Living alone | | |
| | | | | Divorced | Wid-owed | Single | | | Divorced | Wid-owed | Single |
| | | | | | | **Western Germany** | | | | | |
| A. Total number of persons (1000s) | 14.366 | 7.312 | 5.712 | 656 | 105 | 838 | 7.054 | 5.384 | 752 | 482 | 435 |
| Personal monthly income from GRV | | | | | | | | | | | |
| % shares of total A | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| DM 1 to less than DM 500 | 17.6 | 6.5 | 6.0 | 6.7 | 4.7 | 10.3 | 29.2 | 33.2 | 10.1 | 34.1 | 6.9 |
| DM 500 to less than DM 1000 | 18.8 | 9.4 | 8.2 | 16.0 | 2.5 | 13.4 | 28.6 | 31.1 | 22.1 | 21.4 | 16.5 |
| DM 1000 to less than DM 1500 | 17.4 | 12.0 | 9.7 | 21.5 | 5.9 | 20.8 | 22.9 | 21.8 | 30.2 | 32.0 | 14.1 |
| DM 1500 to less than DM 2000 | 14.8 | 18.0 | 17.7 | 17.9 | 19.7 | 19.9 | 11.5 | 9.5 | 22.2 | 8.4 | 22.2 |
| DM 2000 to less than DM 3000 | 26.6 | 45.4 | 48.3 | 37.5 | 58.4 | 30.1 | 7.1 | 4.2 | 14.3 | 4.1 | 33.2 |
| DM 3000 and above | 4.7 | 8.7 | 10.1 | 0.4 | 8.7 | 5.4 | 0.7 | 0.2 | 1.1 | - | 7.1 |
| Pension per recipient in DM | 1.460 | 1.939 | 2.015 | 1.627 | 2.084 | 1.644 | 964 | 856 | 1.339 | 907 | 1.716 |
| Net old-age income of the person | | | | | | | | | | | |
| % shares of total A | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| DM 1 to less than DM 500 | 12.2 | 1.4 | 0.7 | 2.3 | 2.2 | 5.2 | 23.5 | 29.2 | 8.6 | 0.6 | 3.6 |
| DM 500 to less than DM 1000 | 14.3 | 5.2 | 3.7 | 14.5 | 2.5 | 8.6 | 23.7 | 27.6 | 15.4 | 7.4 | 7.7 |
| DM 1000 to less than DM 1500 | 14.6 | 8.9 | 7.2 | 14.2 | 3.4 | 17.4 | 20.4 | 19.9 | 23.3 | 22.6 | 19.5 |
| DM 1500 to less than DM 2000 | 13.7 | 13.5 | 12.3 | 20.6 | 7.7 | 16.4 | 14.0 | 12.6 | 22.3 | 18.5 | 11.6 |
| DM 2000 to less than DM 3000 | 26.8 | 39.3 | 40.3 | 36.1 | 57.8 | 33.1 | 13.9 | 8.6 | 21.7 | 40.1 | 37.4 |
| DM 3000 and above | 18.4 | 31.7 | 35.9 | 12.4 | 26.4 | 19.3 | 4.5 | 2.1 | 8.6 | 10.7 | 20.1 |
| Pension per recipient in DM | 1.944 | 2.618 | 2.751 | 2.058 | 2.643 | 2.148 | 1.245 | 1.036 | 1.676 | 2.034 | 2.221 |
| B. Private Pensions | | | | | | | | | | | |
| Recipients in 1000s | 7.225 | 4.711 | 3.668 | 312 | 56 | 476 | 2.814 | 2.005 | 332 | 203 | 274 |
| As a % of total A | 52.4 | 64.4 | 67.7 | 47.5 | 53.2 | 56.7 | 39.9 | 37.2 | 44.1 | 42.2 | 63.0 |
| % shares of total B | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| DM 1 to less than DM 500 | 80.3 | 74.8 | 75.4 | 72.2 | 74.5 | 71.3 | 89.6 | 91.5 | 81.4 | 87.4 | 86.6 |
| DM 500 to less than DM 1000 | 12.8 | 15.9 | 15.2 | 19.1 | 14.9 | 19.8 | 7.5 | 6.0 | 14.3 | 9.6 | 8.3 |
| DM 1000 to less than DM 1500 | 3.9 | 5.1 | 4.9 | 5.0 | 4.3 | 6.9 | 1.9 | 1.7 | 2.0 | 1.6 | 3.9 |
| DM 1500 and above | 3.0 | 4.2 | 4.5 | 3.7 | 6.4 | 2.0 | 1.0 | 0.8 | 2.2 | 1.4 | 1.3 |
| Pension per recipient in DM | 351 | 419 | 421 | 430 | 353 | 407 | 237 | 213 | 333 | 233 | 294 |
| | | | | | | **Eastern Germany** | | | | | |
| A. Total number of persons (1000s) | 4.153 | 2.072 | 1.685 | 201 | 35 | 151 | 2.080 | 1.629 | 232 | 120 | 99 |
| Personal monthly income from GRV | | | | | | | | | | | |
| % shares of total A | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| DM 1 to less than DM 500 | 2.8 | 1.5 | 0.8 | 6.0 | - | 3.1 | 4.1 | 3.9 | 6.8 | 1.7 | 4.0 |
| DM 500 to less than DM 1000 | 22.0 | 12.6 | 11.8 | 16.6 | 9.0 | 16.6 | 31.3 | 33.1 | 24.7 | 31.5 | 18.5 |
| DM 1000 to less than DM 1500 | 46.9 | 40.8 | 40.6 | 42.4 | 37.4 | 42.3 | 53.0 | 52.2 | 54.1 | 60.2 | 55.3 |
| DM 1500 to less than DM 2000 | 25.8 | 40.7 | 41.9 | 32.6 | 51.3 | 35.9 | 10.9 | 10.3 | 12.9 | 6.6 | 22.2 |
| DM 2000 to less than DM 3000 | 2.4 | 4.3 | 4.7 | 2.4 | 2.3 | 2.1 | 0.6 | 0.6 | 1.4 | - | - |
| DM 3000 and above | 0.0 | 0.1 | 0.1 | - | - | - | - | - | - | - | - |
| Pension per recipient in DM | 1.268 | 1.424 | 1.445 | 1.298 | 1.453 | 1.345 | 1.113 | 1.105 | 1.123 | 1.101 | 1.230 |
| Net old-age income of the person | | | | | | | | | | | |
| % shares of total A | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| DM 1 to less than DM 500 | 1.6 | 0.6 | 0.1 | 4.6 | - | 0.9 | 2.6 | 2.4 | 5.1 | - | 2.5 |
| DM 500 to less than DM 1000 | 16.4 | 7.5 | 6.5 | 12.4 | 4.6 | 13.4 | 25.3 | 28.2 | 21.8 | - | 17.0 |
| DM 1000 to less than DM 1500 | 37.6 | 32.2 | 32.0 | 36.1 | 14.5 | 34.1 | 42.9 | 44.4 | 47.5 | 12.3 | 45.2 |
| DM 1500 to less than DM 2000 | 31.7 | 42.1 | 42.9 | 32.8 | 65.0 | 40.4 | 21.3 | 18.1 | 18.2 | 63.7 | 28.3 |
| DM 2000 to less than DM 3000 | 10.4 | 14.3 | 15.1 | 11.2 | 11.4 | 10.0 | 6.6 | 5.6 | 5.7 | 22.0 | 7.1 |
| DM 3000 and above | 2.3 | 3.2 | 3.4 | 2.9 | 4.5 | 1.2 | 1.3 | 1.3 | 1.8 | 2.0 | - |
| Pension per recipient in DM | 1.495 | 1.668 | 1.694 | 1.531 | 1.852 | 1.509 | 1.322 | 1.271 | 1.306 | 2.011 | 1.359 |
| B. Private Pensions | | | | | | | | | | | |
| Recipients in 1000s | 2.291 | 1.214 | 1.032 | 99 | 16 | 67 | 1.077 | 843 | 122 | 64 | 48 |
| As a % of total A | 55.2 | 58.6 | 61.3 | 49.3 | 46.7 | 44.2 | 51.8 | 51.7 | 52.8 | 52.8 | 48.4 |
| % shares of total B | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| DM 1 to less than DM 500 | 92.8 | 89.4 | 90.2 | 85.5 | 90.4 | 83.3 | 96.6 | 96.3 | 98.6 | 96.2 | 97.0 |
| DM 500 to less than DM 1000 | 5.2 | 7.3 | 6.7 | 9.1 | - | 16.7 | 2.7 | 3.1 | 1.4 | - | 3.0 |
| DM 1000 to less than DM 1500 | 1.1 | 1.8 | 1.9 | 2.3 | - | - | 0.3 | 0.4 | - | - | - |
| DM 1500 and above | 1.0 | 1.5 | 1.3 | 3.2 | 9.6 | 0.0 | 0.4 | 0.3 | 0.0 | 3.8 | 0.0 |
| Pension per recipient in DM | 207 | 246 | 238 | 325 | 334 | 231 | 163 | 148 | 135 | 438 | 135 |

Key: -: Not listed.

1 Microsimulation on the basis of the legal provisions and income variables prevailining in 1996.

Source: Klaus Kortmann and Christoph Schatz, *Altersvorsorge in Deutschland 1996 (AVID '96). Lebensverläufe und künftige Einkommen im Alter*, published by the Verband Deutscher Rentenversicherungsträger (Association of GRV funds) and the Federal Ministry of Labour and Social Affairs, Munich 1999.

are not to be abandoned, in particular the avoidance of poverty and 'maintaining living standards', then the pre-funded component – to the extent that it is supposed to offset a reduction in the pay-as-you-go pension – should be compulsory.

The goal of 'diversifying' the different risks of yield trends in the GRV and private old-age insurance could also be pursued by other means than the seemingly indiscriminate cut in the pension level. For instance, the scope for private provision could also be raised by reducing the ceiling on income subject to contributions *(Beitragsbemessungsgrenze),* which in the longer run would also reduce the burden of expenditure in the GRV. The low-income people would not face a bigger poverty risk. However, in such a case, those on low income would not benefit from the opportunities to diversify risks and earn high interest rates.

In any case the German government must ensure that it informs those groups who, for the first time, opt to rely on individual retirement accounts that these opportunities are matched by additional risks. Capital yields fluctuate considerably. In future certain cohorts of pensioners may find that their expectations of a high private pension are disappointed.

Individual responsibility would be increased if old age insurance were made generally compulsory, including an obligatory minimum contribution. This would also improve the chances of reforming the system of widow(er)s' pensions. In order to ease the burden on the GRV in the longer term, it could then be considered whether to place part of the provision for survivors on the basis of a private, pre-funded insurance.

At the very least, government subsidies for saving should not run counter to the goals of targeted income distribution policy. The planned limitation of support to those employees paying compulsory contributions to the pension insurance scheme (GRV) would be just as problematic as a subsidy based on the number of children that took no account of household income.

Given that the mere debate on the obvious uncertainties regarding income in old age will serve to increase the propensity to make private provision, it is necessary to reform the regulation of life insurances in Germany.

The most important issue, however, is to improve the real-economic conditions that will enable an adequate income to be paid to the elderly in future, despite the rise in life expectancy. Alongside a rational immigration policy, and an increase in the effective retirement age, this presupposes above all else that men and women who are willing to work actually find jobs.

Ellen Kirner, Volker Meinhardt and Gert G. Wagner