COUNTRY SPOTLIGHT GERMANY

All smoke, no fire

German politicians have spent much of the past 20 years trying to improve the coverage and sustainability of the country's pensions system. David Adams **reports on the latest attempts at and suggestions for reform**

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At first glance, the German pensions system appears to be in pretty good shape. The 2018 Melbourne Mercer Global Pension Index gives it a 'B' rating. Germany's score for adequacy is the highest in the index, at 79.9, but a below average score for sustainability (at 44.9) drags it down from the 'A' rating achieved by the Netherlands and Denmark; and leaves its overall score below another 10 countries, including five in Europe.

It is perfectly possible for German workers to achieve a good retirement income, but the current system makes this more difficult for some groups, particularly lower earners. Research from Fidelity suggests that Germans should now be saving 21 per cent of their household income for retirement if they wish to avoid a fall in living standards when they stop work.

The first pillar of the German system is an earnings and contributions record-based, pay-as-you-go state pension, with additional means-tested support for those on lower incomes. A second pillar of voluntary occupational schemes is dominated by DB arrangements, although 2019 may see the first of a new type of collectively-agreed DC scheme launched. The third pillar of private pensions has achieved limited scale and success.

The sustainability of the pay-as-you-go first pillar is threatened by demographic change in an ageing society. The International Monetary Fund calculates that public expenditure on pensions in Germany will have to increase by 1.9 per cent of the country's GDP between 2016 and 2040, compared to an average rise of 0.8 per cent of GDP across the EU.

Reforming ambitions

This problem has been well understood for a long time and reforms have been implemented by a series of governments during the past 20 years. The earliest of these, beginning in 2001, was intended to reduce the replacement rate guaranteed by the state system; and has resulted in a 15 per cent reduction in the level of the pension. At the same time plans were implemented to increase the official retirement age to 67 by 2030. These reforms were combined with measures designed to improve pension provision via the second and third pillars, but those ambitions were not achieved, in part because the fall out from the 2008 financial crisis has restricted both wage growth and investment returns during the past decade.

In recent years some government action has been taken to soften the impact of first pillar reforms on groups adversely affected by them. This has included more support for people on lower incomes, for workers who have taken a career break to raise children; and for those who had previously been heavily penalised by the system for taking early retirement for medical reasons.

But significant concerns remain. "In the long run the course of public policy is still on the wrong track and the level of public pensions will steeply decline," says IG Metall political secretary Dr Katrin Mohr.

IG Metall is the largest trade union in Germany, representing workers in the metal and electrical industries, including automotive, manufacturing, engineering and communications. It is running a campaign to improve coverage offered by the pensions system, called 'Mehr Rente – mehr Zukunft' (More pensions – more future), advocating a gradual increase in the level of the state pension and further protection for lower income workers and those with gaps in their contributions record.

"Our view is that the public pension should not just provide protection against poverty, but should allow you to maintain your standard of living in retirement," says Mohr. "A lot of people cannot work until the age of 67. Workers in physically demanding jobs should have the choice to leave the labour market earlier."

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IG Metall also favours altering the current state system to bring in more contributions from workers who currently use alternative means to save for retirement, including self-employed workers and freelancers, civil servants and politicians. "If you could bring *[contributions from these workers]* into the public system you could strengthen the financial basis of the public system and make the system more just," says Mohr. She suggests employers and employees could share the cost of higher contributions and that a greater share of tax revenues could also be used to help improve funding of the system.

Mercer's index recommends greater protection for lower earners, but also suggests taking measures to increase coverage of employees in the second pillar, improving communications with scheme members; and supporting older people who would like to retire gradually, rather than stopping work altogether when they reach retirement age.

Occupational hazards

The second pillar is affected by several problems. One is its varying quality: workers in larger firms are more likely to have good occupational pensions; and employers in eastern Germany tend not to be able to offer pensions as generous as those in the west. In March 2018, Willis Towers Watson published research suggesting the only way pensions provided by the second pillar could cover the savings gap created by the falling level of the state pension would be if contributions to second pillar pensions doubled.

Lower income workers and women are not always well served by the second pillar. This is due to the the way it relates to the state pension and benefits system – means-tested support for those on lower income in retirement may be denied to some people because they are members of occupational schemes – and because of rules that penalise workers on lower incomes seeking to defer contributions.

Some action has been taken that may help to improve the situation, including new tax incentives to encourage employers to provide better occupational pensions. "With the new Company Pensions Act Betriebsrentenstärkungsgesetz *[BRSG]*, which came into effect in January 2018, limits for tax-favored contributions to pension funds were increased; and this may contribute to higher occupational pensions for certain groups of employees," explains Willis Towers Watson head of retirement, Germany and Austria, Heinke Conrads.

BRSG also enables the introduction of pension funds without guarantees: DC-like schemes that would be created through collective agreements between employers and employee representatives. But so far none of these new schemes has been created. If not enough progress is made soon, another option that may appeal to policymakers would be a regime based on compulsion.

Deutsche Rentenversicherung Bund (Federal Institute for German Pension Insurance) senior economist Markus Sailer would also like to see more reform of the third pillar, which he says currently delivers healthy profits to pension providers but mediocre outcomes for savers. "Maybe some more consumer-friendly regulation of the private pension industry would be helpful," he suggests.

Mercer Germany chief actuary Thomas Hagemann says Mercer would like to see the introduction of a service that gave consumers access to information relating to pensions savings across all three pillars.

"We are working on cross-pillar pension information, where all this information will be aggregated, but this is not easy," he says. "You are dealing with different companies, different IT systems; and companies don't want to give all this information to the statutory pension system. But it's really important to have something like this: it would strengthen all the pension pillars."

Most of these ideas and themes are now being discussed by a Pensions Committee set up by the government to discuss future policy, which will start to report back on its findings later in 2019.

"They must deal with integration of public and private pensions and look at how the pension system will interact with *[the social security system]*, so that the incentive to save will remain for lower earners," says Sailer. "There is a growing sense in the social policy debate that there must be more coordination of policies across the different schemes."

Mohr believes pensions reform is vital for government as a means of helping to provide stability in society. "It's important for social cohesion: the insecurity people feel about pensions feeds into the rise of right-wing populism," she says.

And Hagemann emphasises above all the need to improve pension coverage for lower earners. "One area where the German system does not compare well is in the alleviation of poverty in retirement," he says. "This is an issue that must be resolved." In a country as economically powerful as Germany, it must be hoped that this ambition, at least, is achievable. ■