OECD Pensions at a Glance 2021

HOW DOES GERMANY COMPARE?

Pension benefits shielded from COVID-19

As in most other OECD countries, the impact of COVID-19 on pension income of current and future retirees is likely to be limited due to protective measures. As legislation in Germany prevents negative pension indexation, the income of current pensioners will not decline if wages or employment decrease. Moreover, employers are reimbursed for social security contributions paid for workers in job retention schemes and workers in these schemes accrue full pension entitlements. Yet, COVID-19 may have a long-term negative impact on the future pensions of young people who were not yet in the labour market when the pandemic broke out; they may enter the labour market later and miss years of contributions.

Balancing pension financing within limits

Germany has an automatic balancing mechanism in its mandatory earnings-related pension scheme. It adjusts the pension point value to 25% of the change in the pensioner-to-contributor ratio (the sustainability factor), and also adjusts the contribution rate to a level that ensures that the public pension reserve fund lies between 0.2 and 1.5 times the average monthly pension expenditure. In principle, these rules ensure that the pension scheme is financially balanced every year. Yet, there is also a regular federal subsidy to the pension scheme, which in 2020 covered 30% of pension spending.

However, the balancing mechanism can only make corrections within certain limits. First, the value of the pension point value cannot decline in nominal terms. The catch-up factor, which compensates for non-implemented negative indexations by reducing later positive indexations, was suspended in 2019 until 2025. This hampers the balancing of the scheme, and can under certain circumstances even lead to pensions increasing faster than wages. The new government plans to move forward the reactivation of the catch-up factor to 2022. Second, a double red line (*Doppelte Haltelinie*) introduced in 2018 sets limits to the adjustments the balancing mechanism can make until 2025: adjustments of the pension point value cannot result in the net replacement rate of an average-wage worker with a 45-year career falling below 48%; and the contribution rate cannot exceed 20%. Any deficits that may result from these limits are to be covered through increasing the federal subsidy to the pension scheme.

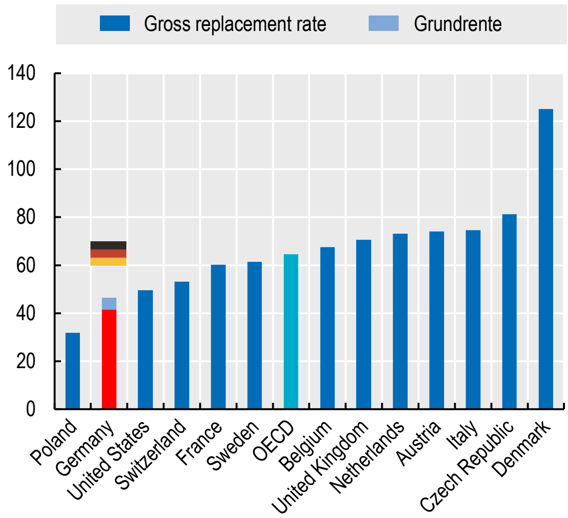
Improved income protection for low-earners

Due to the sustainability factor, future gross replacement rates in Germany are low in comparison to other OECD countries: a person entering the labour market at age 22 in 2020 with a full career on average earnings can expect a gross replacement rate of 41.5% compared to an OECD average of 51.8%. Before 2021, the same future gross replacement rate applied to low income earners (at 50% of average earnings).

In 2021, however, minimum income protection in old age was substantially increased through the *Grundrente*, a supplement topping up the pensions of low-income pensioners who contributed for at least 33 years. It doubles the pension points earned, to a maximum of 0.8 points per year of contributions (i.e. 80% of average income).The supplement may raise contributory pensions by as much as around 90% for retirees who worked for at least 35 years at low wages. The full amount of the supplement is paid to pensioners with monthly taxable income of up to EUR 1 250 for a single person or EUR 1 950 for a couple. For higher incomes, the supplement is withdrawn at a 60% rate for income below EUR 1 600 and EUR 2 300, and at the full 100% for income above these limits. The *Grundrente* increases the future gross replacement rate of a person making half of average earnings by 5 percentage points (p.p.) to 46.5%, compared to the OECD average of 64.5% – although its impact can be substantially higher for people making less than half of average earnings.

Germany has low future replacement rates for low earners

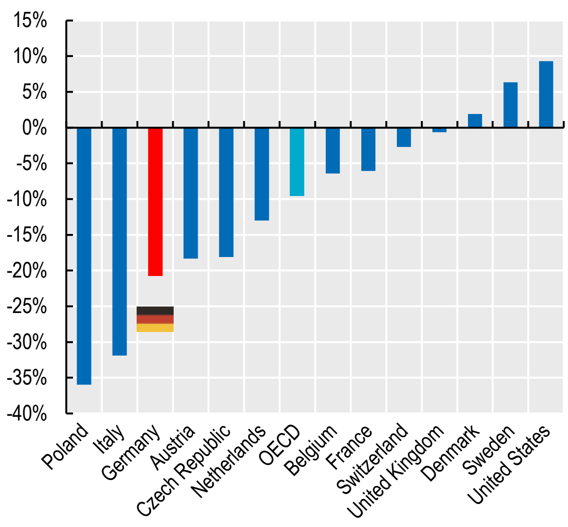
Gross pension replacement rates if earning 50% of average wage



Source: Table 4.1

German working-age population will fall sharply

Change in the working-age population (20-64), 2020-2060



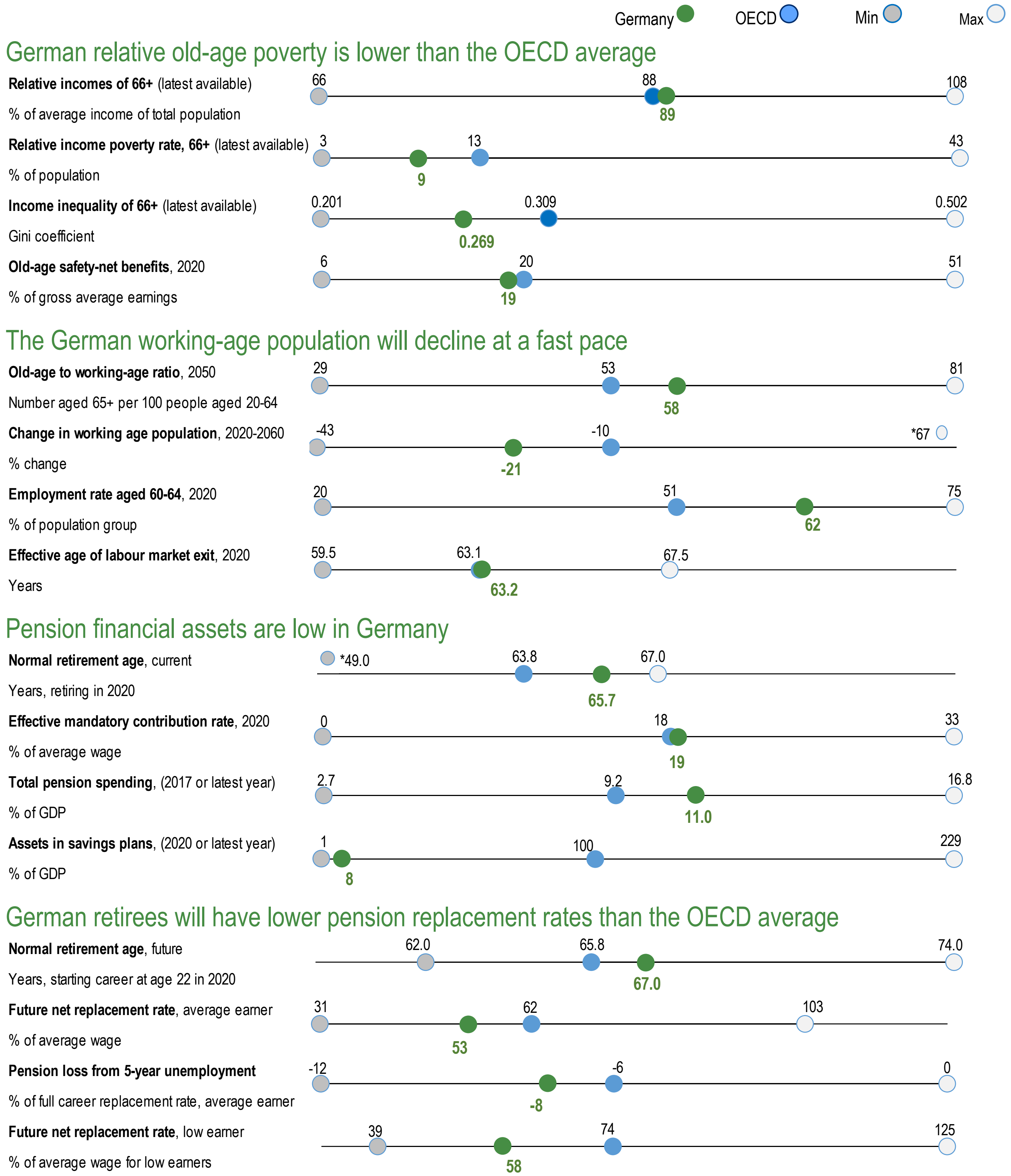
Source: Figure 6.5

PENSIONS AT A GLANCE 2021 © OECD 2021

Sharp fall in the German working-age population

The German working-age population (20-64) is projected to fall by 20.8% between 2020 and 2060, a decline twice as fast as the OECD average (9.6%). Between 2000 and 2017, the pressure exerted by population ageing on pension expenditures was already the fifth highest among OECD countries, but was largely offset by increased employment. As a result, Germany is one of only five OECD-countries where pension expenditures as share of GDP declined over this period, by 0.6 p.p.

In no other OECD country has the evolution in the labour market since 2000, in particular with the stark increase in the employment rate among people aged 55-64, been so favourable to limit pension expenditure. Between 2000 and 2020, the employment rate in this age group increased by 35 p.p., the third largest increase in the OECD. However, there remains some margin for employment to increase further, in particular among people aged 65-69.



PENSIONS AT A GLANCE 2021 © OECD 2021

Contacts: Wouter De Tavernier (+33 1 45 24 96 10; wouter.detavernier@oecd.org), Monika Queisser (+33 1 45 24 96 34; monika.queisser@oecd.org)