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SOCIAL INEQUALITY IS NOT AN ISSUE FOR GERMAN RETIREMENT SYSTEM

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The German pension system is only an average performer among OECD countries and has to go through further reforms. A good starting point might be erasing the privileges of the civil servants.

The German pension system finds its roots in the times of Otto von Bismarck, the great statesman who was Minister of Prussia from 1862 until 1890. During his stay in power, the "Iron Chancellor" not only had unified the divided German states into a powerful German Empire under Prussian leadership, but also he had paved the way for the creation of the first modern welfare state, of which the pension system was a core pillar.

The "pay-as-you-earn" principle that constituted the core of the Bismarckian system has persisted until today: you will get paid on the basis of what you have contributed during your life. This principle automatically entails that citizens working a lot and constantly throughout their working life have larger amounts of money deducted from their salaries and hence will benefit of higher retirement payments as seniors; vice versa, people receiving a low income or taking career breaks shall cope with lower pension payments during their retirements.

Therefore, the equivalency principle creates discrimination against low-income earners. In addition to that, the Bismarckian system is designed to function in times of high and stable unemployment: but in times of financial crisis and staggering social inequality, it just pushes an increasing larger part of the population upon the brink of pensioner poverty.

Despite the massive pension reform implement by the Schroder's government in 2001 (which introduced a three-pillar and market-oriented approach) and despite still being in a good financial shape, the pension system in Germany is put under increasing pressure by several issues which make the system-implosion scenario not such an unreal possibility.

According to the Factsheet "Pension at a Glance 2015 - Germany", the Organisation for Economic Co-operation and Development (OECD) has stated that although the constitutional reforms have improved the situation overall, German pension system shall be rated as "average" as it is still lagging behind other more performing actors such as France and the Netherlands.

Moreover, OECD experts have outlined several structural problems that shall be addressed by the national authorities:

1. The worse issue that Germany is facing is rapid population ageing. Consequently, Germany will spend 12.5% of GDP on public pensions by 2050, against 10% on average in the OECD. The situation has changed in the past few years, as Germany has welcomed a significant number of refugees, the majority of which are younger than 25, there is a potential counterbalance to the aging population in the long term if the youngsters get to be integrated into the social and economic system of their host country;

2. The net pension replacement rates (i.e. the ratio of salary that will become retirement paying) for future retirees are below the OECD average. Therefore, average-wage workers in the country can expect to witness a 50% replacement rate in the future compared to OECD 63%;

3. The *Renterquotienten* (i.e. the ratio retirees-contributors) is expected to increase from 53% to 75 %, thus entailing that there will be less contributors for each retiree. Consequently, retirement age is likely to increase;

4. The value of the old age safety net is relatively low. Individuals who have never contributed to the pension system receive 19% of the average earnings against 22% on OECD average;

5. The poverty rate of people over 65 stands at 9.4%. Although it is below the OECD average of 12.6%, it is still much higher than in other European countries including Denmark, France and the Netherlands;

6. Vulnerable groups, and especially women who constitute two-thirds of Germany's current pensioner, will be the most hit by retirement-income adequacy, thus risking to fall below the poverty threshold.

As highlighted by OECD retirement expert Monika Queisser, the core issue is intrinsic to the system: "One hundred percent orientation on income means that there is hardly any redistribution for those who are socially vulnerable. Switzerland, New Zealand and the Netherlands have better regulated their systems for those with low paying jobs or physical disabilities".

As results from this panorama, Germany appears to be in dire need to reform its pension system to avoid major disruptions in the future. If we were the heads of the German contribution authorities, we would kick off by knocking at the door of the civil servants who, thanks to all the other actors in the system, have been allowed to escape the conspicuous financial contributions to the states' retirement funds.

How does the German system work?

Since the 2001 constitutional reforms, the German retirement contributions' system is funded upon three pillars:

1. Mandatory State Pension Insurance (*Gesetzliche Rentenversicherung*): the first pillar is centred on the “pay-as-you-earn” system, which relies on contributions by employees, employers and governmental subsidies. The contribution rate is equally shared between the employee and the employer with a current annual contribution;

2. Voluntary Occupational Pension Insurance: employers can choose between two different funding methods (Direct Pension Promise or Direct Insurance, presenting several possibilities). This is the retirement contribution provided by the private companies, which may pay an extra to their employees’ state pension on a voluntary basis;

3. Private Pension: citizens may choose to increase their retirement income by investing into a private pension with several options (e.g. the *Riester Pension Plan* or the *Rürup Pension Plan*), for which the state supplies a part.

The problem with the members of the civil service lies upon the fact that the civil servants are indeed entitled to receive retirement contributions by the German state without being obliged to pay monthly allocations. This old privilege entails that the civil servants, and the officials first and foremost, receive a *Pension* without giving any contributions, whereas the other citizens receive the so-called *Rente* which depends on monthly contributions. The oddest circumstance is that the Pensions for public employees are often significantly more consistent than the retirement incomes of the law-abiding taxpayers. Independently from the quality of their work, the German public servants have indeed been entitled to receive a salary on a fixed tariff and likewise a pension on a fixed tariff which although it is not unreasonably high, it’s higher than what is perceived by the average worker in the private sector and moreover guarantees 100% of stability.

Despite the several privatizations of the posts, of the universities and the railways promoted by the German government in these last years and despite the new workers fall under the regime of the ordinary state pensions, the “old” employees have maintained their status and privileges.

Two more aspects make this social inequality even more treacherous.

On one hand, as the OECD has remarked in its study, although women tend to be receive lower pensions, women are better provided in this regard, thus marking a deep inequality.

On the other hand, as argued by Moody’s report “Civil Servants' Pensions Pose Fiscal Challenges, Partly Addressed by Reforms” published in January 2016, although the German state was already devoting 1.6 % of its GDP to pay the civil servants’ pensions, the trend keeps going upwards at both national and regional level and will assume bigger and bigger proportions in the upcoming years.

Moreover, all the employees of the public sector that have been privatised following the latest reforms have been kept under the previous regime. And why this privilege? Because civil servants have been granted the status of *Beamte* (civil servant) for life, and therefore it is impossible to expropriate them of what they have considered as an acquired throughout their whole career because it would entail to dismantle one of the fundamental pillar upon which the entire system is held. Moreover, as this layer of the population never paid contributions, there is no possibility to establish criteria to grant them a pension out of the blue.

Despite the evident social injustice and the upcoming threats, the German government has enacted both significant privatizations of formerly public institutions and reforms to implement a smooth transition in its bureaucratic apparatus, by considering the supply the former civil servants under the previous regime must be a part of the equation. This position is unsurprising: taking away long-term established privileges from a large part of the electorate will require a lot of political capital, which cannot be dispersed by the authorities just months ahead the general elections. It goes without question that the matter will be underplayed in the electoral debate, if it will be treated at all.

However, the German government should bear in mind that also the law-abiding taxpayers also represent a big part of the electorate, in addition to being the backbone of the pension contributions' system. Therefore, the government should be aware that if the question arises during the electoral debate, it will require a convincing explanation.

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