Social Security Abroad

Flexible Retirement Feature of German Pension Reform*

In light of the growing need and public demand for reform and aided by the favorable financial situation of the social security pension system, the Federal Republic of Germany has enacted the first major revision in old-age and disability insurance since 1957.[1] Effective January 1, 1973, the new legislation is aimed at permitting flexible retirement and benefiting insured persons whose pensions were below the social assistance level, as well as population groups previously not covered at all. The innovations in the system (1) replace the fixed retirement age of 65 by a "flexible" formula that gives a worker the option of drawing his pension between ages 63 and 67; (2) speed up the adjustment of benefits by reducing the interval between wage increases and benefit adjustments; (3) introduce special "minimum" pensions for low-wage earners with long service; and (4) extend eligibility for coverage to the entire population.

BACKGROUND

Since 1916, the Germany social security system had provided for retirement at age 65 for men. In recent years, however, many labor representatives, social security planners, and other theorists have come to hold the view that requiring a worker to continue on the job until he reaches age 65 in order to earn a full pension is no longer appropriate. They maintain that the pace of modern life has accelerated to such an extent as to exhaust many workers at an earlier age. Yet men who no longer feel able to keep up with job requirements have been forced to continue and, if they can no longer cope with arduous or demanding work, are sometimes transferred to other jobs with lower pay or status. Other workers, displaced from their regular trades by technological advances, become unemployed or have to shift from a highly skilled or specialized job to whatever they can find.

The announced aim of the Government and of the trade unions in promoting what they termed a "flexible" retirement age was to make retirement for those with a "full working life"—35 years and beyond—more "humane." This meant giving them greater latitude in making the retirement decision, so that mental and physical considerations could prevail over purely chronological ones.

Reflecting this point of view, the reform provides additional choices for workers anticipating retirement that include:

(1) as before, retirement at age 60 for men who have been unemployed for at least 52 weeks within the past 18 months and, for women if they have spent at least 10 of the past 20 years in the labor force;

(2) beginning January 1973, retirement pensions at age 62 for severely disabled persons;

(3) beginning January 1973, normal retirement at age 63 or 64 for any worker with 35 years of coverage;

(4) as before, retirement between ages 65 and 67, after at least 15 years of work, but now with special increments for those eligible to retire at age 63 if they continue to work beyond age 65.

The result is, in effect, the creation of long-service leave—with a minimum of 35 years of contributions required. The acquisition of that many years of credit is considered relatively easy for the average German worker, since most begin full-time work at age 18 and creditable periods during which the insured person is prevented from making contributions are credited towards retirement.

Previously, early retirement—except for disability or long-term unemployment—had been impeded by (1) the statutory retirement age up to which it was customary to remain in the labor force and (2) the financial sacrifice entailed in withdrawing before that age. Even though Germany had no retirement test, official statistics

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[1] For an outline of the system, see *Social Security Programs Throughout the World, 1971* (Research Report No. 40), Social Security Administration, Office of Research and Statistics, 1972, pages 78–79; see also Max Horlick and Alfred M. Skolnik, *Private Pension Plans in West Germany and France* (Research Report No. 36), Social Security Administration, Office of Research and Statistics, 1971, pages 35–37.

indicated that, as in most other countries, economic activity dropped off sharply after age 65, although it was permissible to earn a full wage and draw a full pension at the same time. The reform permits those with long working careers to claim their pension before age 65 and reduces the financial sacrifice for earlier retirement. The advantage of the new formula over the old can be seen in the accompanying table, which assumes that the beneficiary's earnings were at the national average level.

Old Formula

Under the previous old-age pension formula, illustrated in the table, a worker who dropped out of the labor force before age 65 would normally be losing his pay while not yet eligible for an old-age pension. After 36 years, for example, assuming his lifetime earnings were at the national average level, he would have accrued 54 percent of the wage base but could not normally receive this amount if he retired at age 61. Only when he reached age 65 could he collect the pension, in this case 60 percent of the base after 40 years. (The formula is based on the number of years worked, with roughly 1.5 percent of the wage average added for each additional year.)

As indicated earlier, it was possible to apply for a pension sooner than age 65, only because of disability or unemployment. For occupational disability—not complete incapacity for any work but inability to carry on the usual job—the accrued benefit amounted to only 1 percent instead of 1.5 percent a year before age 65. Under this system a retiree would receive, after 35 years, only 35 percent instead of the normally accrued 52.5 percent shown in the table. For incapacity for any work, rated at 50 percent or more, the invalidity pension was computed like the old-age pension (1.5 percent a year); it was not necessarily as high because periods of unemployment or training, or other periods in which no contributions were made, were not credited, as they would be for the old-age pension.

The long-term unemployed (for 12 months in the last 18) and women with at least 10 of the last 20 years in covered employment could retire on reaching age 60 and claim a pension. Their benefit was not actuarially reduced but, unlike regular retirees, they were required to withdraw completely from gainful employment; thus at age 60 they would, after 35 years, have accrued only 52.5 percent of their base earnings, instead of 60 percent as at age 65.

New Formula

The new provisions inaugurate retirement pensions from age 62—3 years earlier than previously—for persons severely disabled through war or other causes and those whose work capacity has been reduced by 50 percent or more. Disability pensioners will now have their pensions converted into old-age pensions at age 62, and those who become disabled between ages 62 and 65 will immediately receive an old-age pension, instead of as previously at age 65. This change is to their advantage since the periods in which no contributions were made will be credited as insurance years as they had not been for disability pensions. It is expected that about 47,000 eligible disabled persons will benefit from this legislation in 1973.

The qualifying conditions for women and for long-term unemployed persons retiring at age 60

Percent of earnings replaced at specified retirement age and number of years worked, under old and new formula

Retirement age	Years worked	Old replacement formula: Percent of formula earnings	Old replacement formula: Accrued annually	New replacement formula: Percent of formula earnings	New replacement formula: Accrued annually
60	35	52.5	1.5%, not collectible	52.5	1.5%, not collectible.
61	36	54.0	1.5%, not collectible	54.0	1.5%, not collectible.
62	37	55.5	1.5%, not collectible	55.5	1.5%, not collectible.
63	38	57.0	1.5%, not collectible	57.0	Payable. No accrual if retired; if working, 1.5%.
64	39	58.5	1.5%, not collectible	58.5	Payable. No accrual if retired; if working, 1.5%.
65	40	60	Payable and 1.5% accrued if working	63.6	Payable or 8.7% accrued.
66	41	61.5	Payable and 1.5% accrued if working	69	Payable or 8.7% accrued.
67	42	63	Payable	70	Payable.

have been relaxed by the new legislation. They are now permitted to engage in some paid work with no reduction in the amount of their pension, if their annual earnings do not exceed one-eighth of the contributions base.[2]

Most important, the new legislation liberalized the conditions under which older workers can begin to draw a retirement pension before reaching age 65. From January 1, 1973, workers with 35 years of insurance credit who are neither disabled nor long-term unemployed can retire and receive a pension at age 63. If they wish, they may concurrently engage in part-time employment, without effect on their pension, in one of two ways: (1) up to 3 months (75 workdays) in each year without earnings limit or (2) regular work with earnings up to 30 percent of the contributions base—in 1973, this ceiling amounts to DM 8,280 a year or DM 690 a month.[3] (The pension is withdrawn for each month in which earnings exceed the limit but is reinstated when earnings fall below the limit.) In accordance with existing legislation, this limitation is lifted entirely when the worker reaches age 65.

Alternatively, a worker who is eligible for retirement at age 63 may defer claiming his pension and continue to work and make social security contributions. If he does so beyond age 65, he will earn, besides the additional 1.5 percent of his basic pension a year, an increment of 0.6 percent for each month worked between age 65 and age 67. In addition, the periodic adjustments to wage increases and other economic factors will make the deferred pension relatively higher than that paid at age 63.

Despite these incentives for able workers to remain on the job beyond age 65—desirable in view of the country's continuing manpower shortage—some German officials have estimated that 70–90 percent of those becoming eligible for retirement at age 63 will claim their pension. Their number is estimated at 335,000 in 1973, rising to 1.7 million by 1985. The planners assume that deferred retirement will be sought mainly by those with insufficient insurance credit for a full pension at age 65, those in good health who like their work, and workers with considerably younger wives to whom they wish to leave the higher survivor benefit contingent upon later retirement.

Adjusted-Income Pensions for Low Wage Earners

Since the 1957 pension reform, there had been no statutory minimum benefit amount. With the formula tied to the number of years worked, persons in the labor force from apprenticeship or school until retirement age would normally be expected to earn an adequate pension amount. Furthermore, as previously indicated, the system gives credit for certain periods in which little or no wage is earned—during unemployment, for example, training, or rehabilitation, and during wartime. The regular working lifetime could, therefore, be almost 50 years.

This very factor of longevity of service had, however, resulted in bringing down the level of pensions for certain categories of workers. In the German pension system—where the entire working career counts—very low wages earned many years ago could drag down the lifetime average. Women, for example, often had lower pay scales than men. Unskilled workers and persons in poor regions or declining industries such as textiles, agriculture, and forestry might never have been able to bring up their averages. Even West Germany's current economic progress and prosperity, although they tend to eliminate low pay categories, could not offset the disadvantageous effect of long-past years on the level of current pensions for these beneficiaries. To overcome this problem, the new legislation provides for an examination of the records of all insured persons with at least 25 years of compulsory contributions and of all current pensioners. All those whose annual earnings were less than 75 percent of the national average in any year between January 1957 and January 1973 will be credited as though contributions had been made at the 75-percent level and their career earnings retotaled, for benefit purposes, on the more favorable basis. Some 750,000 current old-age and disability pensioners (about 7 percent of the total) are expected to benefit substantially. For many of them the pension will double, according to the Minister for Labor and Social Order.

Those whose pensions are low because they are based on earnings less than 40 percent of the

[2] In 1973, 26,700 Deutsche marks.

[3] As of Dec. 31, 1972, one Deutsche mark equaled $0.35 U.S.

national average will not, however, be included in the revaluation on the theory that such earnings did not constitute their principal source of income but were probably marginal to other activities.

Adjustment Mechanism Advanced

Because of indications that pensions have not kept pace with wage-price rises, especially during the past 2 years, the "dynamic" adjustment process introduced in 1957 has been speeded up. Under the dynamic process, benefits (and the contributions ceiling) are adjusted periodically on the basis of increases in national average earnings. At the end of each year, an average of the national average wage for the 3 preceding years is calculated.

The growth in this figure over the previous average is used in determining pension adjustments for the next year. For example, the increase in the average for 1968–70 over that for 1967–69 is calculated at the end of 1971 and applied to 1972. A certain lag element is thus built in, inasmuch as new retirement pensions or pension increases are based not on the current national wage level, but on that of 2½ to 3½ years before.

Previously the adjustment was made on January 1 of each year. The new legislation advances the adjustment date by 6 months, to the previous July 1. The increase scheduled for January 1, 1973, has been made retroactive to July 1, 1972, and the adjustment originally scheduled for January 1, 1974, now becomes due on July 1, 1973. Two advantages resulted for the workers. First, the time lag between wage changes and benefit increases has been lessened; second, they received a one-time retroactive bonus at the end of 1972.

The 1957 adjustment formula had been designed to permit pensioners to participate in economic progress. The aim had been to keep pension levels at about 60 percent of a comparable income from work. In recent years, however, partly because of slack periods in the 1960's, pensions were found to have declined to as low as 42.5 percent of current national average wages. Because of the lag effect, the pension adjustment scheduled for 1972 amounted to only 6.3 percent, since it had not yet caught up to the wage increases that averaged about 14 percent in 1970 and brought a corresponding surplus in pension funds. To minimize a possible similar lag effect in the future, the new law added a guideline for determining future adjustments: The average pension earned after 40 years of coverage should be 50 percent of current national average wages and, even in the event of adverse economic conditions, must never fall below 45 percent.

Extension of Coverage

The new legislation further opens up coverage to groups of the population not previously under social security. It offers the opportunity for all citizens, including those living abroad, and for foreigners with long-term residence or employment in Germany to join the pension system on a voluntary basis and gain a benefit through regular contributions geared to their income. It should be pointed out that in the past voluntary insurance has not been adjustable to wage changes.

The two main groups affected are the self-employed and nonworking women. Previously, certain self-employed, such as those in agriculture and artisan work, were already covered by special systems. Now the remainder can be covered on either a compulsory or voluntary basis. The difference is that under compulsory insurance they will have to pay the full regular 18-percent contribution and will be entitled to full benefits on the same basis as those already in the system. As voluntary members, they themselves determine the amount of their contributions and receive a commensurate benefit.

About 750,000 self-employed persons not yet covered by any special system have a 2-year open season in which to choose either compulsory or voluntary coverage. White-collar workers formerly excluded from regular coverage when their earnings exceeded the limit in the law may now reapply for regular coverage until December 31, 1973. About 7 million housewives and 2 million unpaid family helpers will have a special system that includes health and rehabilitation benefits. The amount of their eventual cash benefits de-

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TABLE M-2.—Public income-maintenance programs: Hospital and medical care payments, 1940–73

[In millions]

Period	Total	OASDHI (health insurance for the aged)[1]			Other programs			
		Total	Hospital insurance [2]	Medical insurance	Veterans	Temporary disability [3]	Workmen's compensation[4]	Public assistance [5]
1940	$165				$70		$93	
1945	222				97		125	
1950	832				573	$7	200	$52
1955	1,265				688	20	325	232
1960	1,846				848	41	435	522
1961	2,093				899	46	460	688
1962	2,406				940	46	495	925
1963	2,611				971	50	525	1,065
1964	2,890				1,019	51	565	1,255
1965	3,204				1,072	52	600	1,480
1966	4,898	$1,019	$891	$128	1,137	54	680	2,008
1967	9,554	4,549	3,353	1,197	1,328	53	750	2,873
1968	12,107	5,697	4,179	1,518	1,429	55	830	4,096
1969	13,837	6,603	4,739	1,865	1,573	59	920	4,681
1970	15,574	7,099	5,124	1,975	1,793	66	1,040	5,576
1971	18,064	7,868	5,751	2,117	2,087	71	1,150	6,888
1972	20,779	8,643	6,319	2,325	2,409	75	1,280	8,372
1972								
March		785	581	204	204			705
April		664	487	177	181			704
May		694	519	175	205			683
June		829	613	216	206			690
July		496	372	124	200			681
August		605	440	166	214			749
September		889	646	243	200			710
October		817	597	220	211			729
November		742	538	204	211			713
December		708	509	199	204			707
1973								
January		781	579	203	229			694
February		717	526	191	201			705
March		852	639	213	219			777

[1] Benefit expenditures from the Federal hospital insurance and supplementary medical insurance trust funds as reported by the U.S. Treasury.

[2] Represents payments in behalf of all persons aged 65 and over, including those not insured for cash benefits under OASDHI and railroad retirement. Excludes payments by Railroad Retirement Board for beneficiaries in Canadian hospitals.

[3] Benefits in California and New York (from 1950), including payments under private plans. Monthly data not available.

[4] Benefits under Federal workmen's compensation laws and under State laws paid by private insurance carriers, State funds, and self-insurers. Beginning 1959, includes data for Alaska and Hawaii. Monthly data not available.

[5] Federal matching for medical vendor payments under public assistance began October 1950.

Source: U.S. Treasury and unpublished data from administrative agencies.

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pends upon the contributions schedule they select. Fifteen years (180 months) of contributions remains, however, the minimum requirement for the receipt of any old-age pension, as under existing legislation.

All those who enter the pension system under the new legislation will have the option (until 1975) of making extra contributions for periods dating back to 1956 in order to bring up their eventual benefit level. Without such contributions those approaching retirement age would not, of course, receive a benefit. Those nearing retirement age but without any previous coverage will get special assistance in making retroactive contributions.

Financing

Estimates of the additional cost incurred by the revisions vary greatly. It is expected that, at least until 1985, it will be met by (1) the existence of a sizable current surplus in pension funds, (2) a previously planned 1-percent increase (from 17 percent to 18 percent) for 1973 in the payroll tax for old-age, survivors' and disability insurance, and (3) the fact that, although new entrants into the system will be paying contributions, they will not become eligible to receive benefits for 10–20 years.