Social Security Abroad

Earnings Index and Old-Age Benefits in West Germany*

The present German social security pension system, inaugurated in 1957, incorporates an indexing-of-earnings process that has generated increasing interest in recent years Because of this interest in the details of the workings of the process, it is described here

When the German worker retires, his lifetime earnings record (average annual wage) is established and then calculated as a percentage of a standard national wage base used in determining all old-age benefits The result is applied to the benefit formula to produce the worker's own benefit amount

The aim of the German system is to enable the beneficiary to maintain the standard of living to which he was accustomed during his working life The old-age benefit is based on full career earnings, rather than on earnings during the last 20, 10, or 5 years, as in many other countries

Originally, this approach was based on the national philosophy that "work makes life sweet" and that hard work should be rewarded In line with that tradition, the benefit formula was related to the number of years worked, with an increment for each year of service

Indexing the Worker's Earnings

The need to revalue was obvious since 40 or even 50 years are theoretically taken into account and since wage levels have increased twentyfold during the lifetime of a worker retiring in 1975, for example A simplified process has therefore been developed to accomplish this revaluation The actual wage record is no longer used for computation, but rather a figure showing the relative standing of the retiring worker in the labor force —in other words, a percentage of the national average

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The Ministry of Labor and Social Affairs publishes each year a national earnings figure for all manual and nonmanual workers[1] This average is shown for 1960–75 in table 1, based on data prepared annually by the Federal Statistical Office, on the basis of a sample survey The annual average gross earnings for 1965, for example, was DM 9,229 and it rose to DM 9,893 in 1966

Each year, the individual worker's earnings, as recorded for contribution purposes, are related to the national average for the year If the applicant was a highly skilled or white-collar worker, for example, he might have earned 50 percent more than the national figure and his standing for the year would thus be 150 This figure is entered into the worker's record and becomes his "personal basis of computation " At the end of a working career, the average figure for all years is calculated

The average worker in manufacturing would typically have begun as an apprentice, earning only a fraction of the national average He would gradually receive higher and higher pay until attaining the level of the national average earnings Subsequently, greater skills and seniority might bring him far above that level in his later years Possibly his earning power might decline shortly before retirement For such a career, the ratio of the lifetime overall earnings to the national average might be 125 percent

Standard National Wage Base

Next, the concept of the standard national wage base comes into play in working out the benefit amount The same wage base is used to calculate the benefits of all workers retiring in a given year This base is the average of the national earnings figures for the third, fourth, and fifth years before retirement, as shown in the second column of table 1 To illustrate For workers retiring in 1975, the national averages for 1973 (DM 18,295), 1972 (DM 16,335), and 1971 (DM 14,931) are averaged, and the result—DM 16,520[2]—is the standard national wage based for that year In other words,

[1] Apprentices and trainees are excluded from this figure because young people in these categories may be paid less than minimum wages since they are in the process of acquiring skills

[2] One U S dollar equaled 2 586 DM, as of June 30, 1976

TABLE 1—Average covered earnings and standard national wage base in Germany, selected years 1960–75

Year	Average covered earnings	Standard national wage base
1960	6 101	5,072
1961	6 723	5,325
1962	7,328	5 678
1963	7,775	6 142
1964	8 467	6 717
1965	9 229	7,275
1966	9,893	7,857
1967	10,219	8,490
1968	10,842	9 196
1969	11,839	9,780
1970	13,343	10 318
1971	14,931	10 967
1972	16,335	12,008
1973	18 295	13 371
1974	20,381	14,870
1975	21,808	16,520

Source Der Bundemeister für Arbeit und Sozialordnung (Bonn), *Ubersicht uber die Soziale Sicherung*, 1974, and *Sozialbericht 1976*, 1976

the standard national wage base represents an average of 3 years

This step was taken to even out sudden jumps or, theoretically, drops in average wages resulting from substantial changes in pay through collective bargaining or brought about by recession The lag incurred in using wage averages of 3, 4, and 5 years before retirement was intended to have a countercyclical effect It was anticipated that inflationary jumps in a given year or two would not immediately mean higher benefits (since the indexing of pensions is tied to this mechanism) or a jump in the national calculation base In the event of sudden inflation, such as occurred during the oil crisis, big wage increases have been granted, with consequent increased revenues for the social security system The effect on pensions and on the indexing of earnings was, however, not only postponed for several years, but diffused in the 3-year average

Computing the Individual Benefit

To arrive at the individual benefit amount, the worker's average wage index is multiplied by the standard national wage base Thus, for the average worker in manufacturing, retiring in a specific year, the standard national wage base for that year multiplied by his average index produces an amount that becomes his assumed lifetime wage to which the benefit formula is applied With all the factors taken into account, the procedure works as follows

> The average industrial worker who retired at the end of 1975 has overall career earnings amounting to 125 percent of the average covered wages of all workers The national standard wage base for that year was DM 16,520, which was used in the benefit formula to determine his personal average—1 25 times DM 16,520 = DM 20,650 If the worker had 40 years of covered employment, he would receive 1 5 percent of his personal average for each year, or 60 percent His annual benefit figure thus would be 0 60 times DM 20,650 or DM 12,390

Problems of Application

Inevitably, complications arise in applying such procedures, particularly with respect to those workers who earned very little or made no contributions at all in given years Before 1972, extremely low wages permanently dragged down the lifetime average No statutory minimum benefit existed, and the many years spent in apprenticeship and training could have a significant effect Women often had lower pay scales than men Unskilled workers and persons in poorer regions or declining industries such as agriculture and forestry might never have had an opportunity to bring up their lifetime averages

In 1972, consequently, the records of all insured persons with at least 25 years of compulsory contributions and of all current pensioners were examined Those whose annual earnings were less than 75 percent of the national average in any year between January 1957 and January 1973 were credited as if contributions had been made at the 75-percent level, and their career earnings were retotaled Workers earning less than 40 percent of the average were not affected, since they were considered to be casual workers only

Credits are granted for periods in the armed forces or for periods of job loss connected with the Nazi and World War II period Special provision is also made for periods of disability, rehabilitation, covered unemployment, and pregnancy, under a variety of formulas