PUBLIC SECTOR PENSIONS IN GERMANY

By Anke Freibert

Principal Administrator, Sigma
Paris, France

Seminar on

"Social Rights and Pensions for Civil Servants in some EU Member States"
Vilnius, 9 November 2006

Civil Service Dept. under the Lithuanian Interior Ministry
and Sigma

The pension systems in the German public service

(Only about one third of the staff in the German public service is civil servants)

1. The pensions of civil servants

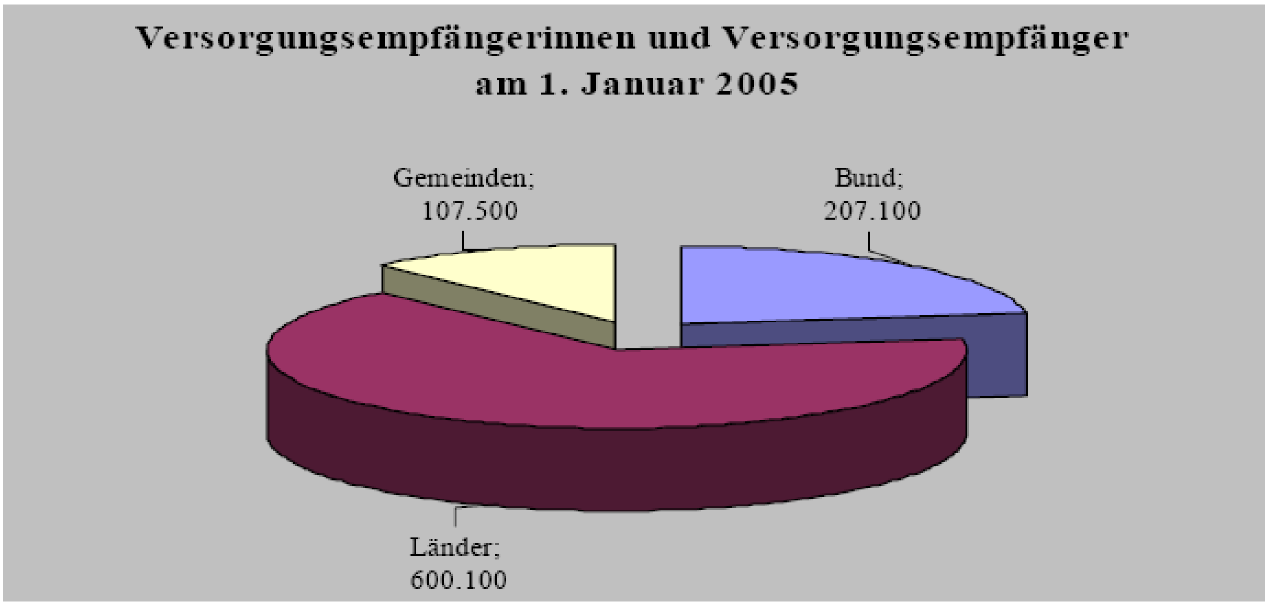
Pensions of civil servants in the Federation, the *Länder* and local authorities are determined uniformly by the Act Governing Civil Servants' Pensions and Allowances (*Beamtenversorgungsgesetz* — BeamtVG); corresponding provisions also apply to judges. Pensions for professional military personnel are governed by the same principles under the Military Pensions Act (*Soldatenversorgungsgesetz* — SVG).

Pensions are a part of personnel expenditure and are paid exclusively by public employers and directly from their current budgets. Civil servants do not have to contribute to the general statutory social security and pension scheme; under the special tax-funded system no contributions are levied. This is however taken into account in the gross remuneration of civil servants. Civil servants' entitlement to an appropriate pension is one of the traditional principles of the civil service and is protected by the Constitution.

Civil servants receive a pension once they are retired. This happens:

- when the general retirement age (at age 65) or a special retirement age (for police and prison staff, as well as professional fire brigades: at age 60) has been reached;
- on request from age 63 onwards (severely disabled: from age 60 onwards); or
- if permanent invalidity has been established.

On 1 January 2005 there was a total of approx. 914.700 pensioners (including their surviving dependants) at the federal level, in the *Länder* and the local authorities.



Of the 914 700 pensioners at the federal level, in the *Länder* and local authorities, 615 000 (almost 62.9%) are former civil servants, judges or military personnel; the others are surviving dependants (widows/widowers and orphans). Also in other areas of employment the majority are direct beneficiaries, as opposed to their surviving dependants: With the former Deutsche Bahn there are approx. 134 800 (60%), with the former Deutsche Bundespost approx. 207 100 (76%) and in the indirect public service approx. 15 500 (67%) direct beneficiaries.

Since civil servants are not protected by the general statutory accident insurance, the pension scheme for civil servants also includes accident benefits. Where civil servants are injured or killed by accidents at work, the employer reimburses them or their surviving dependants for medical and nursing care and material costs, and compensation is provided where appropriate for a reduction of earning capacity. If a civil servant has retired because of an accident at work, he/she receives an increased accident pension under certain conditions.

Pension benefits are adjusted to general developments in the economy and in income in the same way as remuneration, in each case through a federal act.

In contrast to pensions from the statutory pensions insurance and the supplementary pension scheme for public employees, pensions for civil servants are regarded fiscally as income from work and — apart from an annual tax allowance of € 3 000 — are fully taxable. *This tax system is under reform and both retirement schemes will be treated equally as of 2040.*

To be entitled to a pension, a civil servant must have served a minimum of five years or must have become an invalid in the course of an accident at work. The entitlement generally requires the civil servant to be employed in the public service until retirement.

Should the civil servant leave the public service prior to retirement, he/she will be insured retroactively with the general statutory pension scheme (but not in the supplementary pension scheme for the public service).

Calculating pensions

Pensions are calculated on the basis of pensionable years of service and pensionable remuneration.

Pensionable years of service are in particular times spent in the public service, in the professional or non-professional armed services, in employment in the public service under private law, as well as required training periods.

Pensionable remuneration includes the last basic salary, which the civil servant received for at least three years, and, where appropriate, the family allowance (step 1) and certain allowances expressly referred to in the law as being pensionable. These are the so-called functional allowances which can be paid for the permanent exercise of more demanding activities, but do not include post allowances, extra pay for difficult working conditions or allowances for expenses and overtime.

Until 2003 the max pension was 75% of pensionable remuneration. The maximum pension is reached after 40 years. By 2010 the maximum pension will be 71.75% of pensionable remuneration. For part-time work, only the respective share of full working hours is counted as pensionable years of service. Nonetheless, the full-time remuneration is taken as the basis for determining the pensionable remuneration.

The special age limits for professional military personnel constitute a special case, resulting from the specific requirements in terms of physical fitness, and also from the requirements of the armed forces themselves. Generally, it is not possible for them to reach the maximum pension solely on the basis of years of service; this disadvantage is compensated for by an increase in the pension rate according to age.

Times of unpaid leave (e.g. child-raising leave) are generally not pensionable unless it was recognised in writing in advance that the leave was also in the interest of the public service (e.g. in the case of leave to accept a position in other national or international institutions, such as the EU or UN organisations, something which is in the German public interest).

For times of child raising — as is also the case in the statutory pensions insurance — a supplement to the pension is paid under certain conditions.

If the civil servant retires before reaching the statutory retirement age, the pension will be reduced by 3.6% for each year by which the civil servant retired before reaching the statutory retirement age (65 years of age, for police officers 60 years of age) (maximum reduction of 10.8%). For severely disabled civil servants and civil servants unfit for work the statutory retirement age is 63 years.

In the event of early retirement because of invalidity the following provisions apply:

- If the civil servant becomes an invalid before reaching the age of 60, two-thirds of the time until the age of 60 is added to the pensionable years of service to calculate the pension.
- If the civil servant has become an invalid as a result of an accident at work, the accident pension is at least 66 ⅔ % of pensionable remuneration.

Retired civil servants receive a minimum pension if this is more beneficial to them. It is 35% of pensionable remuneration (including the full family allowance), at least (including the full family allowance) € 1 290.97 (in the old *Länder*) and € 1 196.44 (in the new *Länder*); data 1.8.2004.

As is the case with active civil servants, all pensioners are entitled to an annual special bonus, which in 2004 amounted to 50 % of one monthly pension on the federal level; in the *Länder* the amount differs considerably. The annual special bonus is not an additional payment made to pensioners, but a share of their annual pensions which is paid out only in December. It is mainly the employer who benefits from this special mode of payment by earning interest on this amount; otherwise the employer would have to pay a higher pension each month and thus up to 11 months earlier. By contrast, statutory pensions are paid out in 12 equal monthly shares.

Provisions regarding other pensions

If civil servants or their surviving dependants receive other pensions or benefits from statutory pension schemes or from a supplementary pension scheme for public employees or surviving dependants in addition to their regular pensions, these are deducted from their regular pensions where the total of all benefits exceeds a maximum fixed ceiling.

If retired civil servants or surviving dependants earn money through gainful employment, this is deducted from the pension where the sum of the income from work and the pension exceeds the previous remuneration in active service. If, however, the civil servant has retired because of invalidity or on request because of severe disability, he/she may keep the extra earnings only if the income from work and the pension together do not exceed the maximum pension out of the previous remuneration in active service, plus an amount of € 325 per month. After the civil servant reaches the age of 65, his/her income earned from work outside the public service is no longer subject to such deductions, though income earned in the public service remains subject to deduction.

Surviving dependants

In addition to one-off payments (remuneration for the month of death and a death allowance) surviving dependants receive a widow/er's benefit, orphan's benefit or subsistence payments as a pension.

The surviving spouse will in future receive 55% of the pension of the deceased civil servant (previously 60%).

The orphan's benefit is a portion of the pension of the deceased civil servant, amounting to 12% for the loss of one parent, 20% for the loss of both parents and 30% for children who have become orphans as a result of an accident.

On 1 January 2005, approx. 273 900 widows/widowers and 25 300 orphans of former civil servants of territorial authorities were drawing a pension for surviving dependants.

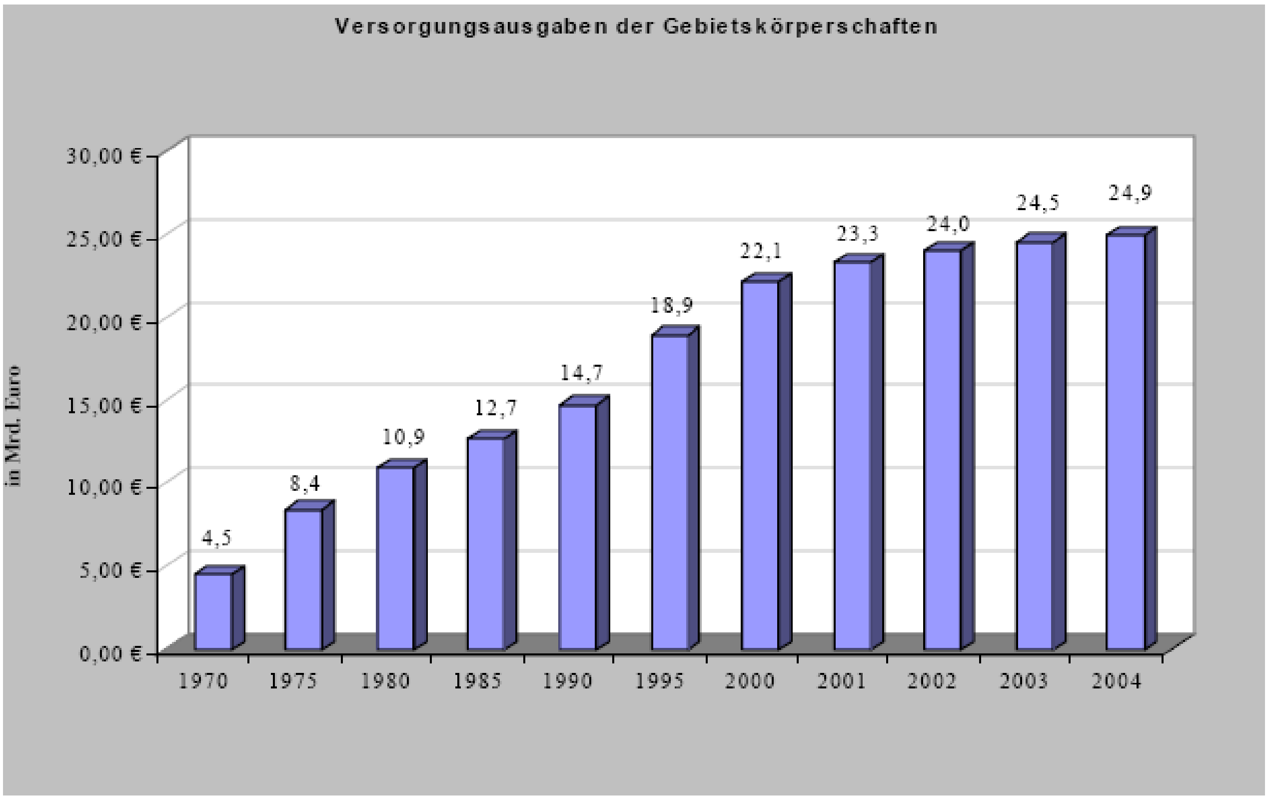
Special groups

Because of their special situation, separate regulations apply to local government officials elected for a limited period of time, particularly to mayors and chief executives of a county. Their pensions are based on more favourable pension rates than those of civil servants with life tenure; they also have greater freedom to earn extra income in the private sector. Additionally, statutory provisions under Land law apply, which may vary in the different *Länder*.

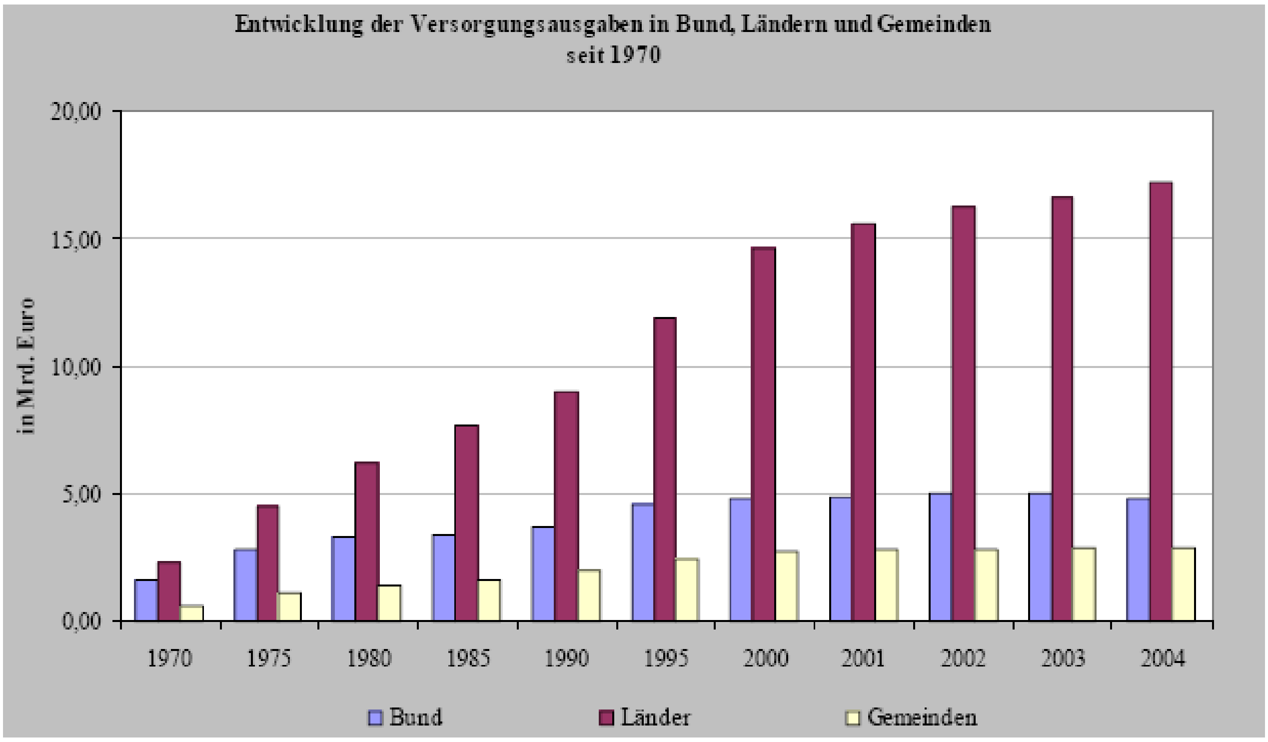
Special provisions also apply to political civil servants who may be suspended at any time even without their consent. Depending on their years of service, they then receive a maximum pension based on their pensionable remuneration for at least six months up to a maximum of three years. After this period their pension is governed by the general provisions applying to pensions of civil servants. However, they receive a pension on a permanent basis only if they have been in service for at least five years. If additional income earned outside the public service and the pension together exceed the last remuneration from active service, only half of the excess is deducted from the pension.

Pension expenditure

Since 1970 the pension expenditure of territorial authorities has developed as follows:



Total expenditure in the Federation, the *Länder* and local authorities has developed as follows:



In 2004 the pension expenditure by the Federation, the *Länder* and local authorities was € 24.9 billion. The Federation accounted for € 4.8 billion, the *Länder* for € 17.2 billion and the local authorities for € 2.9 billion.

Reform of the pension system for civil servants

Because of demographic developments, expenditure for the pensions of civil servants — as for other pension schemes — is expected to increase considerably. The main reason is increasing life expectancy coupled with lower average retirement age. The average retirement age — both for the pensions of civil servants and for the statutory pensions insurance scheme — is approx. 61 years, and hence four years lower than the general mandatory retirement age. Furthermore, the effects of the considerable increase in staff in the 1970s necessary at the time because of society's increased demands on the state represents an additional burden on the public service pension system.

According to the second Pensions Report of the Federal Government of 2001, the pension expenditure of the Federation, the *Länder* and local authorities will more than quadruple, rising from approx. € 22 billion in 2000 to approx. € 90 billion in 2040. This will represent an increasing burden on the budgets of the *Länder*, in particular.

To make expenditure for the pensions of civil servants sustainable for the long run, the system has been changed several times since 1992. To this end, the reform measures introduced for the statutory pension insurance, which are intended to reduce costs, have been introduced accordingly for the pension system of civil servants. With the introduction of pension reserves in 1998 the first steps were taken towards a fully funded pension system.

The amendments to the Act Governing Civil Servants' Pensions and Allowances, which entered into force in 1992, the 1997 Act to Amend the Public Service Law and the 1998.

Act to Reform the Pension System contained comprehensive new regulations: Amongst other things, the pension scale was extended from 35 to 40 years, the age limit for pension applications was increased from 62 to 63 years and the inclusion of formal education (university) periods was restricted, the pension in case of invalidity was further reduced, reductions were introduced in the event of early retirement and the regulations on additional income were made much stricter. In order to reduce the number of early retirements, so-called old-age part-time work has been introduced, initially on an experimental basis.

A core item of the 1998 pension reform was the introduction of a provision to create pension reserves. This was done by lowering the increases in remuneration and pensions for civil servants by 0.2% since 1999. For the Federation, the resulting amount is placed in a special fund, which is invested by the Bundesbank in tradable federal bonds and managed by the Federal Ministry of the Interior. The *Länder* have set up their own provisions for creating and employing their reserves. The public budgets will be able to draw on these interest-yielding reserves, which cannot be used for any other purpose, in the future when they are faced with enormous pension expenditures, and thus these reserves will contribute to making pensions sustainable in the long run.

Because of the increasing number of early retirements, pensions are paid for increasingly longer periods. For this reason — as in the statutory pension insurance — pensions have been reduced by 3.6% for each year of early retirement (but not exceeding 10.8%), also for early retirement because of invalidity or severe disability, as from 1 January 2001.

The 2001 Act to Reform the Pension System (*Versorgungsänderungsgesetz* 2001) applied the comprehensive pension reform with the same effect to the civil servants' pension scheme. The main elements of the reform of the civil servants' pension scheme, which entered into force on 1 January 2002, are the following:

- From 2003 onwards, the rate of increase for pensions is reduced by 0.5% annually for the following eight years. As a result, the maximum pension of currently 75% will be gradually reduced to 71.75% by 2010. No pension benefits will be cut, no one will receive less.
- Fifty per cent of the savings resulting from these reductions in public spending will be added to the benefit reserves and will thus continue to be used for the civil servants' pension scheme.
- Those civil servants who provide for old age by putting aside additional savings on a voluntary basis will receive specific allowances or tax benefits by the state as from 1 January 2002 in accordance with the Retirement Assets Act (*Altersvermögensgesetz*) and the Supplementary Retirement Assets Act (*Altersvermögensergänzungsgesetz*), similar to public employees under the statutory pension insurance scheme.
- To avoid any double burden for civil servants and pensioners, the 1998 Act to Reform the Pension System stipulates that the 0.2% reduction in the annual increase in the remuneration of civil servants and pensioners to be added to the benefit reserves will be suspended for eight successive steps from 2003 onwards, and resume from 2011 until 2017.

- Plus a few more provisions.

2. The pensions of public employees

The pensions of public employees (including invalidity pensions and pensions for surviving dependants) are based on three pillars: the statutory pensions insurance, then supplementary pension scheme for the public service and the fully funded private pension scheme eligible for tax benefits.

Statutory pensions insurance

Public employees are insured under the general statutory pensions insurance, in the same way as employees in private industry. It is financed by equal contributions from employees and employers (in 2005 a total of 19.5% of gross salary and wage income up to a specific income threshold) and by public funds. The amount of the pension is not governed by the total amount of contributions paid in, but by the relative amount of the income on which contributions are based, measured against the average income of all insured parties.

Pensions are adjusted annually. These adjustments are linked to the developments in general economic net average salaries (so-called index-linked pensions).

Supplementary pension scheme for the public service

Additionally, public employees are insured under the supplementary pension scheme for the public service. The supplementary pension scheme is based on a collective agreement and is the public service's equivalent of occupational pension schemes. In the past, the supplementary pension was based on an overall pension, which was intended to supplement the statutory pension up to a maximum of 91.75% of the net salary of a comparable active employee. The aim was to bring the pensions of public employees into line with those of civil servants. Because of demographic developments (the increasing number of pensioners in relation to the number of active employees in the statutory pension scheme), the development of pay systems (civil servants' law, statutory pensions and taxes) and because of a supreme court ruling, the funding of the supplementary pension scheme came under increasing pressure. The Federal and *Länder* Government-Service Supplementary Pension Agency (*Versorgungsanstalt des Bundes und der Länder*) alone faced a projected deficit of € 7.7 billion by 2008. This development would have threatened the very existence of the supplementary pension scheme itself. For this reason, the collective bargaining partners thoroughly overhauled the supplementary pension scheme of the public service.

The new "collective agreement on the occupational pension scheme for public employees" (*Tarifvertrag über die betriebliche Altersversorgung der Beschäftigten im öffentlichen Dienst* — ATV) of 1 March 2002 consists of the following main elements:

- The former comprehensive pension system was discontinued retroactively on 31 December 2000 and replaced by an actuarial model of pension credits.
- This model of pension credits is based on occupational pension schemes typically offered by private employers. Benefits are determined independently of any reference systems such as statutory pensions, the pensions of civil servants or taxes.
- In this model, benefits are calculated as if contributions of 4% of the employee's pay eligible for the supplementary pension scheme were being paid into a fully funded system.
- The amount of benefits resulting from the model of pension credits reflect the employee's actual career. The determining factor for the total amount of benefits is now lifetime income. Each employee receives pension credits for each year of employment. They are determined on the basis of an employee's individual annual income by measuring the individual annual income against a reference income of € 1 000.
- Then the pension credits are weighed against the so-called age factor. The younger the employee, the more pension credits he/she will accrue, i.e. the pension account will be credited with more pension credits.
- Upon retirement, the benefit amount is determined by multiplying the sum of all acquired pension credits by € 4.

A pension is paid under the same conditions as for the statutory pension insurance (old age pension, invalidity pension, pension for surviving dependants). If the occupational pension is claimed prematurely, benefits will be reduced by 0.3% for each month the pension is paid out prematurely, with a maximum reduction of 10.8% — as in the statutory pension insurance scheme:

- For invalidity pensions and pensions for surviving dependants, pension credits will be added for each year before the age of 60.
- If employment is temporarily suspended because of statutory child-raising leave, pension credits will be accrued for each child for which the parent is entitled to take child-raising leave. The number of pension credits is based on a fictional income of € 500.

Occupational pensions are index-linked and increase by 1% annually. Since the new supplementary pension system is no longer linked to the amount of statutory pensions, any increase in statutory pensions will no longer be deducted from occupational pensions, but will be paid out in full to pensioners.

Pensions and claims to future pension benefits acquired up to the present will be guaranteed by transitional legislation:

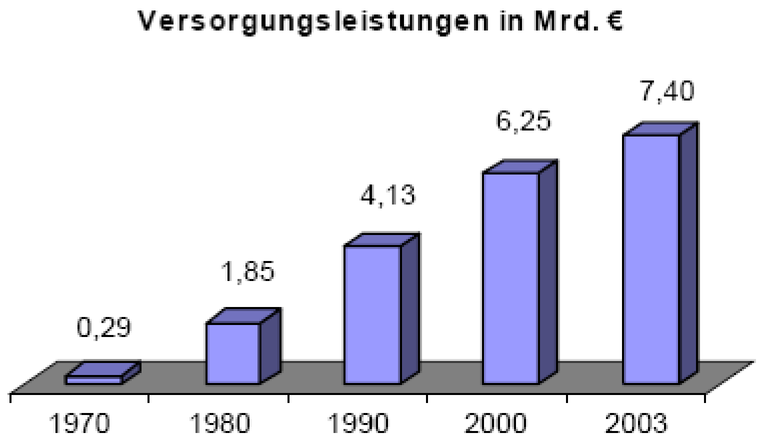
- There will be no changes to pensions currently being paid out.
- Claims to future pension benefits acquired under the old system by employees who are still in employment will be converted to the new system.

Replacing the comprehensive pension system with an ordinary occupational pension scheme gives public employees — similar to employees in the private sector — the opportunity to make their own contributions to set up a private, fully funded pension eligible for tax benefits.

Insurers and pension benefits

The most important insurer is the Federal and *Länder* Government-Service Supplementary Pension Agency (*Versorgungsanstalt des Bundes und der Länder*, VBL) in Karlsruhe. This is where public employees of the Federation and the *Länder*, as well as a number of public employees of local authorities and of other public sector employers, are insured (in 2003 nearly 1.9 million employees insured under the statutory pension scheme; the number of pensions was ca. 1 million with a volume of approx. € 3.9 billion). Most employees of local authorities, as well as of churches and other institutions, are insured with local authority or church insurance funds (in 2003 2.9 million insured employees; the number of pensions was 975 000 with a volume of approx. € 3.5 billion).

The pension benefits of the Federal and *Länder* Government-Service Supplementary Pension Agency and local authority or church insurance funds have developed as follows:



Funding

Until the end of 1998 only public employers contributed to the supplementary pension scheme on behalf of their insured employees (for the VBL the last rate was 5.2% of taxable gross income);

since the beginning of 1999 public employees have also paid into the supplementary pension scheme. Since 1 January 2002 the contribution rate for the VBL has been 7.86% for the old *Länder*. Employers pay 6.45%, while employees only pay 1.41%. In addition, employers pay a tax-free flat rate of 2% to pay for the costs of converting the pension system to the pension credit model. The local authority and church insurance funds have different contribution rates. As from 2002, employers must pay taxes on contributions to the VBL (for the old *Länder*) up to an amount of € 92.03 per month at a flat-rate of 20%. Taxes on contributions to other insurers will have to be paid at a flat rate up to an amount of € 89.48 per month. For any amount going beyond this limit employees must pay taxes individually.

For the VBL (in the new *Länder*) the contribution rate has been 1.0% since the introduction of the supplementary pension scheme in the East on 1 January 1997. The contribution is paid only by the employer.

Taxes and social security contributions imposed on the supplementary pension

Health insurance and old-age nursing-home insurance contributions are deducted from pensions (approx. 7.6% in 2001).

The tax system regarding the general pension system has been reviewed following a judgment of the Constitutional Court. As of 2005, 50% on the general pensions are taxable; in the long run these pensions will be taxed in the same way as civil servants pensions.

Legislation

(The majority of legislation can be found under www.staat-modern.de, while the BAT and salary tables are available under www.bmi.bund.de)