Policy Measures in German Public Pension System to cope with Low Fertility

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1 Introduction

The changing composition of the age-structure of the population in Germany is considered as one of the major challenges to social security systems. The future of the public pension system in particular has become object of a vivid and highly controversial debate, although until today, the public pension system has shown remarkable continuity over the more than hundred years of its history. Despite of various amendments enacted since its inception at the end of the last century the basic principles have outlasted different political regimes, two world wars, two complete monetary depreciations and even the integration of the different pension system of the former German Democratic Republic (GDR) following the re-unification of Germany.

In recent years, the relationship between demographic developments and old-age social security has become a topic of major public interest because of the dramatic ageing of the population. The decline of the birth rate in Germany seems to imply on the one hand - ceteris paribus - a sharp increase in social security contributions in the future and gloomy prospects for younger age-groups as to the financial burdens they will have to bear and the pension benefits they may expect. Yet on the other hand, the old- age social security system is also identified as one of the reasons for the declining fertility rate[1] and as a source of discrimination against families and persons engaged in unpaid care work within the family. As far as pensions are based on income-related contributions as in Germany, caring for children tends to have negative consequences on the level of old-age protection available to the carers, mainly women.

The problem of how to adapt the social security system to the imminent challenges has been widely discussed in Germany. Various proposals have been put forward advocating despensing with one or more basic prinicples of the existing pension system or attempting to question the intergenerational agreement underlying the public pension system in Germany. So far, radical alternatives have not had any significant influence on the reform process. The reforms rely on adaptive measures that will preserve the solvency of the public pension system over the next decade. There is still a broad consensus in maintaining the „basics“ of the existing scheme.

Among the various reforms and reform proposals trying to respond to the demographic developments two sets of policy measures may be distinguished: the first type is mainly concerned with the actual and future financial viability of the public pension system (***economic***

[1] It has been suggested that problems which arise from the prospective decrease in population may well be caused - or may be aggravated - by the peculiar form of current German pay-as-you-go pension schemes themselves. Although this hypothesis is hard to test empirically, the existing theoretical literature in the field of economic fertility behaviour tends to largely back this argument. For details see Werding, Zur Rekonstruktion des Generationenvertrags, 1998, p. 291 ff.

approach). This reform approach is not limited to aspects of fertility decline only or the stagnation of the fertility rate at a lower level than some decades before, but is concerned with both „ends“ of demographic change, fertility and the the growing longevity of the population.

The second type of policy measures focuses on the consequences of fertility decisions on the individual level of protection and the situation of families under the public pension system, with a special concern for mothers and fathers engaged in unpaid child-care work within the family (***equity approach***).

Consequently, the decline of the fertility rate in Germany since the major pension reform of 1957 may be considered a problem for the public pension system for several reasons: From a purely **economic perspective**, low fertility is part of the demographic challenge related to the variations in the age structure which might endanger the financial viability of the system in the future because of unsustainable contribution rates. From a **legal and social policy perspective**, low fertility constitutes a problem in terms of equity between families with children and (the growing number of) childless couples or families, and of discrimination and equal opportunities with respect to adequate social protection for those engaged in unpaid childcare within the family.

When the public pension system was reformed in 1957 it was common belief that „people always do have children“, and that the burden of raising children was being distributed equally among the population. Since the pension reform of 1957 which introduced the pay-as-you-go system as financing mechanism the old-age social security of the great majority is based on the fundamental concept of a „contract between generations“ or the idea of solidarity between generations. [2] According to this concept the economically active part of the population will finance the pensions of the previous generation via contributions to the the public pension system. Hereby they will aquire the right to their old-age protection which again will be paid by the following generation. The functioning of such a system depends on two preconditions:
1. The economically active generation of each period must be willing and capable to produce a social product sufficient to provide for the active generation as well as for the children and for the pensioners.
2. Each active generation must be willing to provide for a subsequent generation.
Childless persons therefore disturb the symmetry of giving and taking, as they do not adequately participate in the costs induced by raising and maintaining children. Thus they neglect one part of the implied solidarity obligations the public pension system is built upon.

[2] For the contract between generations and the public pension system see Burkhardt, Drei-Generationen-Solidarität in der gesetzlichen Rentenversicherung als zwingende Notwendigkeit, 1985; Dinkel, Die Auswirkungen eines Geburten- und Bevölkerungsrückgangs auf Entwicklung und Ausgestaltung von gesetzlicher Alterssicherung und Familienlastenausgleich, 1985, esp. at p. 192 ff.; Borchert, Die Berücksichtigung familiärer Kindererziehung im Recht der gesetzlichen Rentenversicherung, 1981, esp. at p. 143 ff. The idea of the „contract between generations“ as precondition for a public pension system based on the pay-as-you-go method can be traced back to Wilfrid Schreiber, an economist who had great impact on the pension reform of 1957. For an economic analysis of the contract between generations and the economic interdependences of private fertility decisions, public pension systems, and family benefits, see Werding, Zur Rekonstruktion des Generationenvertrages, 1998.

As a matter of fact, the public pension system as conceived by the pension reform of 1957 did not consider that neglecting one part of the solidarity obligations would endanger the functioning of the system on the long run. It considered only the monetary part of the solidarity contributions. The only family related component was the provision of survivors'pensions. Once the birth rate started to decline dramatically in the 1970s, it became evident that the previous assumptions - namely that people would always raise children - did not hold true any longer for a growing part of the population. Those taking up family responsibilities would suffer disadvantages under the pension system since it neglected the non-economic contributions of families, especially when mothers - and to a lesser extent also fathers - reduced or interrupted gainful employment in order to care for dependent children. Once the raising of children can no longer be taken for granted, a public pension system relying on the pay-as-you-go principle cannot avoid to honour the solidarity contribution provided by childraising. In a constitutional setting which pays great attention to the protection of the family as a primordial responsibility of the Social State the normative design of a pension system will be subject to constitutional review if families are disadvantaged.

Two factors have had an incisive impact on legislative developments in Germany throughout the 90s: The re-unification of Germany confronted the legislator with the need to take account of the different family patterns practiced in the former GDR. Besides, the Federal Constitutional Court of Germany obliged the legislator in a landmark decision of 1992 to further improve the family-related components of the public pension scheme and the old-age protection for family members engaged in child-care work.[3] According to the German Federal Constitutional Court the disadvantages in individual old-age protection may be compensated for at least to some extent within the pension system. The decision emphasized in particular the great significance that child rearing has in carrying on the existence of the generational agreement and upholding generational solidarity.

The present papers will firstly recall the main features of the German public pension system and provide some basic statistical data on the situation of the system (II). After summing up the demographic conditions and their impact on old-age social security (III), the paper will then focus on the fertility-related component integrated into the public pension system (IV) and give a summary of other policy measures and proposals that might respond to low fertility (V).

2 The German Public Pension System: Main Features and Statistical Data

The social security in case of old-age, invalidity and death is based on **social insurance** schemes for various groups of the workforce.[4] According to the idea of „social insurance", individual pension benefits are closely linked to compulsory contributions made during

[3] Decision of 7 July 1992, in: Decisions of the Federal Constitutional Court (BVerfGE), vol. 87, p. 153 ff.
[4] The legal provisions on the public pension insurance have been integrated as book VI into the Social Law Code (SGB).

previous periods, when today's pensioners were part of the active labour force. Benefits depend upon both the length of time a person has contributed and the level of past earnings Pension entitlements are based - almost exclusively - on periods spent in gainful employment in the formal labour market. Until the reform of the provision of survivors'pensions and the introduction of child-raising benefits which came into force in 1986 the public pension system did not take into consideration whether people raised children or not except for the entitlements to survivors' benefits. Mothers in particular who gave up their jobs to bring up children could not accumulate contributions on their own right for their old-age pensions.

The current statutory pension scheme has been shaped mainly by the major Pension Reform Act of 1957. The public pension system covers workers and employees in dependent employment, and certain self-employed persons (like craftsmen). Miners are insured with a different insurance scheme which forms part of the statutory pension insurance. Specific categories of the workforce are covered by separate provisions outside the statutory pension insurance (farmers; civil servants; certain freelance professionals). Coverage of the public pension insurance has been extended recently to persons previously excluded from any protection scheme, namely persons in „insignificant employment" and self-employed workers deemed to be in need of social protection on the same level as dependent workers. However, there is still no general, universal coverage of the whole population. Part of the self-employed, and above all those outside the workforce or outside the formal labour market are excluded from the mandatory social insurance system and have to rely on private provision. These persons can, however, be covered indirectly by the statutory pension scheme, as dependent family members (spouses or children) and thus be entitled to survivors benefits.

At the end of 1997 the statutory pension insurance covered 49,6 millions of insured (of which 31,2 millions actively, and 18,3 millions passively insured). The main group of contributors consists of the 25,4 millions of employed persons, the global volume of contributions to the pension system of workers and employees amounting to 298 billion DM. The number of pensions amounted to over 22 millions at the end of 1998.[5]

The old-age pensions depend largely on the individual work and pension insurance history and are related to the length of the insurance period and the amount of the contributions which are a percentage of earned income. If contributions are paid over a period of 45 years on the basis of the average gross salary of all insured persons the pension will be about 70 % of the average net salary of all insured.[6] In practice however, the standard pension is almost virtual, as most of the pensioners never reach that level.[7] As a consequence, a considerable part of the

[5] See VDR, Jahresrückblick 1998, in: www.VDR.de/Internet/vdr/

[6] The pension entitlement related to this scenario is called the benchmark standard pension. During the second semester of 1999 the disposable income of a standard pensioner was about 2000 DM (West) or about 1700 DM (East).

[7] As women still earn on average about only 70 % of the average salary in a given year, they get a lower pension than the standard pension even after a full working career. Even men do not as a general rule receive the standard pension amount. On average they reach an amount corresponding to an average

pensioners, esp. women, have problems to accrue pension entitlements above the existence minimum of about 1.300 DM p.month. There is no general guaranteed minimum pension within the statutory pension scheme.

The legal retirement age has been or is being harmonized at age 65 for men and women alike. A particular characteristic of the German public pension system is the high rate of early retirement. By the end of the 1980s the average age at which blue collar workers drew a pension was well under 60. Only a fraction of retirements took place at 65 and relatively few at 63. Early retirement was promoted by government throughout the 80s and helped firms to adapt to economic downturn induced by the first oil crisis. Until recent reforms implemented gradually since 1992 women had the opportunity to take a pension at 60 subject to meeting certain contribution conditions.[8]

When the currently used **pay-as-you-go** financing system was set up by the pension reform of 1957, the economic prospects were excellent, with strong productivity gains, full employment and with the postwar baby boom.[9] Today, about 80 % of the benefits paid by the public pension system (old age, invalidity and survivor pensions) are financed by **contributions**. The contribution rate has been reduced recently from 20,3 % to 19,5 % (as of 1 april 1999)[10] of the gross salary equally split between the employer and the employee. The reduction is to be financed from additional tax revenue based on the ecology (energy) tax and other tax reforms. Salary above the contribution assessment ceiling (upper income limit)[11] is not subject to compulsory contributions. Some contributions are payed by other social security institutions (e.g. in case of sickness or unemployment).[12] Other sources of income are not subject to compulsory contributions. The consequence is a considerable pression on labour costs esp. in times of high unemployment.

About 20 % of the expenditure is financed from general tax revenue. This subsidy is meant to finance those components of the pension scheme which are considered as not strictly insurance-based, such as periods of military service.[13] The State subsidies from general tax

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salary during 35 years (women collect on average an amount corresponding to only 15 years of average salary.

[8] See Casey, The German Pension Reform of 1989, in: Lloyd-Sherlock/Johnson (eds.), Ageing and Social Policy: Global Comparisons, 1996, p. 36 ff.

[9] Under the pay-as-you-go-system there is no accumulation of funds, the contributions collected in one month serve to finance of the pension benfits of the same month. In order to cope with fluctuations of revenue and expenditure only a small accumulation of funds has to be guaranteed to cover the average expenditure of one month. If the reserves are exhausted the state has the legal obligation to grant loans to the public pension fund.

[10] 19,3 % in 2000.

[11] The contribution assessment ceiling (upper income limit for contributions) is set at 8.600 DM per month in the West (7.100 DM in the East) or 103.200 DM p.a. (West) and 85.200 DM (East) in 2000.

[12] „Hidden" contributions to the public pension system as part of the health - and the unemployment insurance.

[13] The underlying concept of insurance is that only contributions payed in cash legitimate the granting of a pension in an insurance scheme. Whether or not the so-called child-rearing periods should be considered as not-insurance based has been a controversial issue in Germany.

revenue have been increased recently by about 15 billion DM, financed by an increase of the V.A.T. as of 1 april 1998 (from 15% to 16 %). The general subsidy has been 72,7 billion DM in 1998, but according to the Pension Reform Act 1999 the State must pay an additional federal subsidy from general tax revenue to meet the non-insurance based costs not yet covered by contributions. This additional grant amounts to 9,6 billion DM for the period April-December 1998 and to 15,6 billion DM for 1999. As from 2000, this additional federal subsidy will vary annually, corresponding to the change in the yield accrued by value-added tax. Special arrangements have been made to meet the costs of the non-contributory child-rearing credits (see below).

3 Demographic development as a challenge for the public pension system

The demographic situation is determined by two different developments: the increase in life expectancy on the one side, and the low fertility rate on the other side. Both of them induce significant changes in the age structure of the population. At any rate, the dicisive factor is not the low fertility rate alone, but the combined effect of longevity of the population and early retirement which is very wide-spread in Germany.

The general trend of increasing lif expectancy at birth and at age 65 continues.[14] As to the actual age structure, the age group of children up to 15 years is slightly decreasing (16,1 %) as well as the young adolescents between 15-25 years (11 %); the age group between 25-45 years doesn't present variations, whereas the portion of the age group between 45-65 years is increasing (to 25,3 %) as well as the over 65s (to 15,7 %).

According to model calulations on the population dynamics the percentage of the persons over 65 will raise from 15,4 % to 26,7 % by 2030. Whereas in 1992 the rate of persons over 60 in relation to 100 persons aged between 20-60 years was 35,6, it is presumed that by 2030 the ratio will be between 66,8 - 72,6. A doubling of this ratio does not, however, mean inevitably a doubling of the contribution rate or a corresponding cutting of benefits. A main factor influencing the financial situation of the public pension system is the labour market situation and the number of contributors.[15]

As to the fertility trends, the average number of children per woman is 1,3 children (against an average of 1.4 in the European Community). The birth rate has declined sharply after the baby-boom of the mid-sixties, but has slightly increased again since the middle of the 80s to about 700.000 births p.a. (West).[16] The different demographic behaviour of the population of

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[14] 73,8 years for men, 80,0 years for women in the Western part of Germany (71,2 / 78,6 years in the Eastern part); the figures refer to 1994/1996, see: Dorbritz/Gärtner, 1998 Report on the demographic situation in Germany, in: Zeitschrift für Bevölkerungswissenschaft, vol. 23, 4/1998, p. 373-458.

[15] Rolf/Wagner, Alterssicherung in der Bundesrepublik Deutschland. Stand und Perspektiven, in: Aus Politik und Zeitgeschichte, Beilage zur Wochenzeitung Das Parlament, B 35/96, 23. August 1996, p. 23 ff. (24 f.).

[16] The number of births in the Eastern part of Germany is about 100.000.

the former GDR has no measurable impact on the general trend which is characterized by a stable net reproduction rate.

Whether migration policies could or should have a positive effect on the general demographic problems is a highly sensitive issue in Germany. There has been a considerable immigration surplus in the past, but the number of immigrants has been reduced during recent years, especially with respect to immigrants seeking political asylum and other refugees. An official immigration policy is still lacking, and individual immigrants are tolerated only when there is a legal obligation to do so. Residence permits for so-called third country nationals not belonging to the European Union are difficult to get, and the capacity of the German population to accept a significant number of immigrants with a differing cultural background cannot be taken for granted.[17]

As a consequence of the present demographic trends and the given institutional setting of the public pension insurance scheme based primarily on contributions of dependent workers and a few self-employed categories low fertility is hold to threaten the financial sustainability of the statutory public pension system **in the future**, as constant low fertility will worsen the so-called dependency ratio.[18] What will be the impact of the persistently low fertitlity rate? One must distiguish between the time of transition and future periods with a stabilised age structure and persistent low fertility rate. In the tranisiton period there is first a decrease of the child component of the burden of dependence, whereas the increase of the old-age component is coming some 40 years later. Although Germany is currently living a period of relief from the overall burden of dependence, there is no corresponding profit due to unemployment.

In so far as the long-term evolution of the overall dependency ratio is concerned, it has been demonstrated by comparing population models with constant rates of fertility and mortality that there is an optimum point, i.e. a net reproduction rate leading to a minimal overall dependency ratio.[19] The optimum point, however, varies according to three parameters: the average age of entrance to and departure from the workforce; the income relationships of the average young, adult and aged person; and the life-expectancy of the population. As long as the net reproduction rate remains between 0.8 and 1.3 there are no important long-term differences in the overall dependency ratio. A decline of fertiliy below 0.8 would lead to a progressive

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[17] In favour of a targeted immigration policy as alternative measure to sustain the public pension system see Manzke, Kinderlastenausgleich versus verstärkte Einwanderung. Alternative Ansätze zur langfristigen Sicherung der Gesetzlichen Rentenversicherung, 1997. For the integration problems following massive immigrant movements see Schwarz, Beitrag der Bevölkerungswissenschaft zur Bewältigung wichtiger Zukunftsaufgaben in Staat und Gesellschaft, in: Dorbritz / Otto (Hrsg.), Demographie und Politik. Ergebnisse der 32. Arbeitstagung der Deutschen Gesellschaft für Bevölkerungswissenschaft (DGBw), Wiesbaden 1999, p. 170 ff.

[18] The present situation of the dependency ratio is not particularly bad: There are relatively few older citizens because of the low birth rate during the First World War and the death rate among men during the Second World War. One has to consider, however, the future pensioners of the strong birth cohorts around 1938 and the baby boom of the 60s. See e.g. Schwarz, (previous footnote), p. 173.

[19] Kaufmann/Leisering, Demographic Challenges in the Welfare State, in: Oyen, Comparing welfare states and their futures, 1986, p. 96 ff (109).

increase in the overall dependency ratio. This is the case in Germany where the net reproduction rate has remained below 0.7 in the past 20 years.

The worsening of the dependency ratio was calculated to have severe consequences for the financing of old-age pensions, since, all other things being equal, contribution revenue would fall as expenditure on benefits would rise. It has been projected that to maintain a balance between revenue and expenditure for benefits, the contribution rate would have to rise to over 36 % be 2030. According to the 1998 Prognos Report, a study ordered by the Federation of the German Pension Insurance Institutions (VDR) on the long-term development of pension insurance the overall social insurance contributions would rise to 43.2 % in 2010, and to 47,7 % in 2040. Net earnings which on average amounted to about 64,4 % of gross earnings in 1995 are expected to reach only 54.8 % by 2040. As to the public pension insurance in particular, projections show an increase of the present contribution rate (ca. 20 %) up to 22,9 5 - 23.5 % in 2020 , and up to 26.7-27.4 % in 2040. If the 1999 pension reform is implemented, the contribution rate is expected to increase in a very moderate way until 2020, whereas in 2040 the projected contribution rate is 24-25 %.[20]

A number of measures introduced by the pension reforms of 1992 and 1999 aim at mitigating the effects of current demographic trends on the pension system, mainly by establishing more severe eligibility criteria for drawing an insurance pension and by cutting benefits. The general trend is not to increase any further the contribution rate on paid labour in order to promote employment opportunities, to increase the actual retirement age, and to distribute charges stemming from demographic development fairly among those paying contributions and those drawing pensions.[21] The only exception to the general trend of cutting down pension expenditure in recent pension reforms is linked to the recognition of child-rearing periods as mandatory insurance periods under the public pension scheme.

4 Public pension measures to cope with low fertility

4-1 Introduction of special child-rearing periods under the public pension scheme

Until 1986, the statutory pension insurance in the federal Republic Germany did not consider child-care within the family as an issue of public concern. Only working mothers could get - to a very limited extent - some pension credits for periods of maternity leave.[22] Together with the reform of survivors' pensions[23] the legislator introduced a structural innovation to the pension

[20] The final version of the Prognos Report 1998 was published in: Deutsche Rentenversicherung, 1998. An abrigded version can be obtained under http://www.vdr.de.
[21] Esp. by introducing a new indexing mechanism, so that pensions will move strictly in line with net wages after 1992.
[22] Periods of maternity leave (6 months following the birth of a child) were credited at an extremely low level, as the net maternity allowance of 750 DM per month was taken as calculation basis. The value of the corresponding pension credit was related to the effective income situation and amounted to only about 30% of average earnings of all insured.
[23] Hinterbliebenen- und Erziehungszeitengesetz (HEZG) of 11.7.1985. The reform responded to a verdict of the Federal Constitutional Court of 1975 that had ruled that the gender-based discriminations of previous

insurance system: Non-contributory pension credits based on nothing else than on child-raising activities.

As of 1 january 1986, child-rearing has - within certain limits - been recognized as a contribution to the public pension scheme and as equivalent to gainful employment in the labour market:[24] Specified child-rearing periods are counted as insurance periods by law when the child is being raised in Germany. Mothers (and fathers) born in 1921 or later[25] as well as substitute parents in case of step parents, adoptive parents and foster parents were to be credited for with 12 months following the birth as obligatory insurance period for every child born before 1992 without incurring any obligation to pay contributions to the public pension system. The pension reform of 1989[26] extended the periods of obligatory child-rearing credits to 36 months for children born in 1992 or later.[27]

The new child rearing periods count both for the access to pension and for the amount of the benefit.[28] This means that the credit operates independently of the existence of (previous or following) insurance periods based on contributions from gainful employment.

The main reasons for introducing this new concept for pension entitlements (as for further improvements of this benefit) was to up-grade unpaid family work within the family, to „honour“ child-rearing as an activity in the public interest and to improve old-age social security for women in particular. The innovation lies essentially in the fact that child-rearing is considered as an activity deserving pension credits under old-age social security like gainful employment instead of a circumstance hindering gainful employment. The new concept presents certain affinities with the recognition of periods of military service which have a long tradition. In both cases there are pension credits linked to activities of particular public interest, yet outside gainful employment. The main difference lies in the fact that military service is a legal obligation imposed by law whereas parental responsibilities are a consequence of

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provisions governing survivor's pensions would violate the principle of equal rights of men and women guaranteed under art. 3 of the Constitution.

[24] The old-age protection scheme for civil servants provided for the recognition of child-rearing periods under specific conditions and only for the first six months following the birth (sect. 85 § 7 Beamtenversorgungsgesetz).

[25] Only for mothers born before 1921 (in the Eastern part: before 1927) a special benefit is awarded as a seperate supplement of the same value than the credits for child-rearing periods, sect. 294 SGB VI.

[26] For general features of the pension reform of 1989 see Casey, The German Pension Reform of 1989, in: Lloyd-Sherlock/Johnson (ed.), Ageing and Social Policy: Global Comparisons, 1996, p. 36 ff; Schmähl, The „1992 reform“ of public pensions in Germany: main elements and some effects, in: Journal of European Social Policy, 1993, p. 39-51.

[27] Again, the old-age protection scheme for civil servants enacted specific provisions, cf. the Kindererziehungszuschlagsgesetz (KEZG) of 18.12.1989. Later improvements of the recognition of child-rearing periods within the public pension insurance scheme led to corresponding modifications in the provisions for civil servants, cf. KEZG of 29.6.1998. For details see Krahforst/Rudolph, Die verbesserte Bewertung von Kindererziehungszeiten in der Beamtenversorgung, in: Zeitschrift für Beamtenrecht 1998, p. 376 ff.

[28] Sect. 56 SGB VI; sect. 249 SGB VI.

personal (private) decisions of high public utility.[29] Since the long-term costs of interupting employment for child-rearing are reduced an additional effect of the measure could be a higher fertility rate. This consideration however has never been among the explicit reasons for adopting the new policy measure as there has never been any explicit, pro-natalist policy of the Federal Republic of Germany.[30] Therefore the fundamental rational of the policy is the need to recognize child-rearing periods for the sake of equity since they honour an activity indispensable for the future functioning of the public pension system and the society as a whole.

The political significance of the new policy has to be seen against the background of the general trend to retrench the welfare State and to cut down social security expenditure. When introduced in 1986, the new measure partly compensated for benefit cuts enacted by the reform of survivors' benefits. Later improvements of the entitlements took place under similar conditions. The new policy measure has to be seen in the wider context of a set of different family benefits also introduced in 1986 (the parental leave and the child-rearing benefit under federal legislation). Whereas those family benefits were designed as a support of actual maintenance obligations of parents and as an incentive to give up or to reduce gainful employment in order to personally care for a new-born child, the pension credits were seen as an attempt to introduce autonomous pension entitlements on periods of child-rearing. It was clear that the creation of such autonomous entitlements would benefit mainly mothers, who had been disadvantaged under the statutory pension scheme as compared to childless persons with an uninterrupted professional career. Thus, the new measure was not designed to increase the birth rate, but to improve the legal position of mothers under the public pension system by recognizing the equal value of family work and paid work. In the first government draft bill the recognition of periods prior to 1986 was provided for women only. This provision was not upheld because of the constitutional principle of equal rights.[31] However, there is still a priority rule in favour of the mother, if parents have not made a special declaration.

Insurance periods for child-rearing can be attributed to parents who have raised a child providing personal care according to the German civil code. Child-rearing periods can be credited only to one parent for a given period, even if both parents have shared child care equally. When two (or more) parents have participated in the child care during the relevant periods they can only choose to get pension credits for subsequent periods. For child rearing periods after the 31 december 1991 the parents are free to decide which parent shall be attributed the credits.[32] If several children are being raised simultaneously, the parents are

[29] The value of military service periods for pension entitlements has been changed several times (before 1982 100% of average earnings, then 75 % (in 1982), 70 %(1983-1991) and 80 % (since 1992). The value has thus been close to the value attributed to the child-rearing periods although the military service as such is completely indifferent for the functioning of the public pension system.

[30] The reason for stigmatizing population policy and for avoiding even the impression to persue a pro-natalist policy stems from the abuse of population policies during the Nazi regime.

[31] Art. 3 § 2 and 3 of the German Constitution (Grundgesetz).

[32] Sect. 56 § 2 s. 4 SGB VI. The attribution of credits can be claimed only for the future and up to 2 months retrospectively, as long as the social risk covered by the public pension system has not materialized.

entitled to a prolongation of creditable periods in order to fully profit from the child-rearing periods.[33] In the event of simultaneous education the attribution of insurance credits can be limited to one child for each parent. However, if parents do not give a declaration the credits will be attributed to the mother by law. In the event of child-rearing periods before 1.1.1992 (Western part of Germany) there is a general priority rule in favour of the mother. Special provisions apply for the attribution of pension credits among several parents with different types of parent-child relationship.[34] The recognition of child-rearing credits is excluded for parents who are covered by a foreign pension system or by a special protection scheme under national law, e.g. parents covered as civil servants during the relevant periods and therefore exempt of insurance membership under the public pension system.[35]

The new pension credits for child-rearing periods do not compensate for all the disadvantages that parental responsibilities might entail with respect to individual pension entitlements. This becomes most evident when one considers that the length of actual child-rearing periods will go far beyond the three years of credits granted as mandatory insurance periods. A major problem comes from the financing method: The contributions for those periods are not paid during the time of child-rearing, but the burdens of paying for the pension credits are in principle deferred to the following generation, that is the children themselves will have to come up for child-rearing benefits granted to their mothers - instead of the childless persons of the same age group.

Subsequent pension reforms gradually extended the benefits arising from child-raising activities: Although the new Government under Schröder partially suspended the **pension reform 1999** enacted by their predecessors in order to prepare an alternative structural pension reform[36], it did not touch the reform as to the improved consideration of child rearing periods. This improvement had been called for by the Federal Constitutional Court in another land-mark decision of 1996.[37] As a consequence, the value attributed to child rearing periods is being raised gradually in three steps from 75% of average remuneration to 100% of average remuneration as from 1 July 2000.[38]

A further improvement introduced by the pension reform 1999 consists in allowing the child rearing credits as of 1 July 1998 **in additon** to the already existing contribution periods running parallel and up to the respective contribution assessment ceiling. The new additional counting of child-rearing periods recognizes the double burden of working mothers with small children. It may result in a pension increase of up to about 36 DM (30 DM in the East) per month for

[33] E.g. for twins born after 31 december 1991 the child-rearing periods are extended to 72 months.
[34] For details see sect. 56 § 2 SGB VI and *Kreikebohm/von Koch/Krauss*, in: Schulin (ed.), Handbuch des Sozialversicherungsrechts, Vol. 3, Rentenversicherungsrecht, 1999, § 30 p. 753 ff.
[35] Sect. 56 § 4 SGB VI.
[36] The first step towards the announced structural reform has been the „Rentenkorrekturgesetz" of 19.12.1998.
[37] Decision of the first senate of 12.3.1996, in: BVerfGE (= decisions of the Federal Constitutional Court) vol. 94, p. 241 ff. with annotation by Maier, Kindererziehungszeiten teilweise verfassungswidrig!, in: Die Sozialgerichtsbarkeit 1997, 1 ff.
[38] The value had increased to 85% of average income as of 1 july 1998, and to 90 % as of 1 July 1999.

every year of child-rearing. The combined effect of both improvements of the value attributed to the child-rearing periods is considerable, especially in the case of younger age cohorts who had their children after 1991. These improvements are important as they counterbalance benefit cuts enacted by the pension reform of 1999. After the full implementation of the improved consideration of child-rearing periods the value attributed to one year corresponds to a gross salary liable to contributions of about 54.000 DM (about 45.000 DM in the Eastern part). The credits are equivalent to contributions of about 10.900 DM (9.100 DM in the Eastern part).

The previous provision did not allow to count credits for child-rearing if the mother or father had an income from paid work already above 75 % of average remuneration subject to mandatory contributions. This arrangement favoured in particular mothers/parents who left the labour market in line with traditional family patterns. Non-traditional family patterns characterized by the trend of combining family and professional activities were disadvantaged because credits could be cumulated with employment-based entitlements only to a minor extent. This provision had been held unconstitutional by the Federal Constitutional Court since it discriminated against certain categories of mothers who particularly needed or deserved social protection. This was the case of mothers under economic stress, e.g. single mothers who could not rely on a male breadwinner husband, or mothers who had contributed on a voluntary basis to the public pension scheme.[39]

According to the pension reform plan 1999, the value of the child rearing credits has been raised from 85 to 90 % of average salary as of 1 July 1999. 6.3 millions of pensions had to be adapted. The improved accounting of child rearing periods led to an increase of the pension between 2,41 and 43,45 DM per month per child in the Western part of Germany.[40] Accordingly, the average monthly pension benefit based on child-rearing periods is currently 96,55 DM.[41]

Besides the recognition of child rearing periods as pension credits capable of directly creating and increasing pension entitlements, the new pension law in force since 1992 also provided for additional indirect advantages linked to certain child-rearing periods (***Kinderberücksichtigungszeiten***)[42]. This additional advantage does not consist of a further increase of pension benefits, but provides for the maintenance of specific advantages acquired under the public pension scheme, even if these times do not increment the pension amount. They also prevent that the respective periods worsen the parameters used to determine the

[39]Cf. note 36.

[40] Between 2,10 and 37,80 DM in the Eastern part. See VDR, Information aus der gesetzlichen Rentenversicherung, Nr. 5/1999, p. 3 f.

[41] The special benefit of the public pension system introduced for women born before 1921 (in the Eastern part before 1927) has been adapted to guarantee the same level of protection. It was paid to 1,7 million women in 1998. The monthly child-rearing benefit amounts to 43,50 DM per child in the Western part of Germany (37,90 DM in the Eastern part).

[42] Sect. 57 SGB VI. The pension Reform Act of 1989 had extended the relevant periods from 5 to 10 years per child.

value of certain periods not based on contributory obligations (e.g. periods of professional education).

The legal status of credits for child-rearing periods has been controversial. Some tend to qualify them as part of those measures that are conceived as expression of the solidarity principle. Consequently, the costs should be borne, at least partially, by the revenue from contributions. However, legislation has attributed the costs induced by the recognition of child-rearing periods on principle to tax financing from the very beginning. In fact, the policy measure has been conceived as a family benefit integrated into the public pension system. According to the original provisions the Federal State had to restitute the costs incurred by the pension insurance body at the time the benefits were drawn. The pension reform of 1992 which provided for the extension of child-rearing credits didn't change the principle of tax financing explicitly, but replaced the integral restitution of the costs involved by an overall increase of the State subsidy to the pension system.[43] A major innovation in the financing arrangements was adopted by the recent pension reform prepared by the Government of Schröder.[44] According to the new provision the State has to pay real contributions for child-rearing periods as of 1 june 1999. Up to this date the contributions had been financed by the overall state subsidy. Now the child-rearing periods are to be considered as equivalent to „normal“ insurance periods based on gainful employment also with respect to contributions.

So far, the expenditure for pensions payed by the public pension system in Germany comprises only a small amount for child raising periods (ca. 2,1 % in 1999). However, the improvements will lead to an additional expenditure which will rise to 13.6 billion DM in 2030. The increase is due to the fact that there will be more and more female pensioners whose children are born in 1992 or later and who are therefore being credited 36 months per child. The overall expenditure of the public pension system for child-rearing periods will thus increase from 6.9 billion DM in 1999 to up to over 15.5 billion DM in 2010, and to up to estimated 36.1 billion DM in 2030.[45] These figures suggest that the real financial burdens will present themselves in the future and will have to be borne by future generations, namely by the children of the future pensioners. It is highly debateable whether this kind of policy leads to a redistribution of family-related burdens from families to childless persons. In the case of a pay-as-you-go financing system it will always be the children - not the childless - who finance the policy measure.

4-2. Assessment of the policy measure

[43] The re-imbursement based on the estimated level of restitutions during previous years (about 4.8 billion DM) has been added to the overall federal subsidy. It was clear, however, that this would not be sufficient to cover additional costs induced by the extension of child-rearing periods from 12 to 36 months. The reform 1992 implied thus transferring part of the costs related to child-rearing credits to the pension insurance system.

[44] Rentenkorrekturgesetz of 19.12.1998.

[45] See Ruland, Die Zukunft der Rentenversicherung, in: Cramer/Förster/Ruland (ed.), Handbuch zur Altersversorgung, 1999, p. 935 ff. (953).

The recognition of pension credits for child-rearing periods is an important structural innovation to the employment-based statutory public pension system in Germany. It is not just a pension law provision but a family benefit incorporated into the pension system. Although the policy measure's objectives have been somewhat ambiguous in the beginning, subsequent amendments - strongly supported by the Federal Constitutional Court - clarified the legal character and objective of the legislation. The policy has effectively emphasized that under the current public pension system child-rearing activities are an indispensable part of the solidarity between generations and confer direct pension entitlements as does gainful employment. It also effectively compensates for disadvantages and shortcomings in the old-age protection of mothers. There is evidence that these advantages outweigh the benefit cuts otherwise enacted to reduce pension expenditure.

Some technical and financial aspects of the policy measure appear debateable, however, when confronted with actual trends in the design of family benefits. A general objection stems from the impression that the provision is still based on traditional family patterns. There is an implicit assumption that child-care activities are most intensive during the first three years of a child. This assumption may or may not correspond to real needs of families. Secondly, the legal provisions do not seem to encourage parallel joint responsibility of both parents in child-care, e.g. that both parents reduce simultaneously their working-time to care for their child. A splitting of pension credits for parents opting for such an arrangement has been explicitly excluded.

Some serious equity problems related to the financing of this measure might turn up in the future when today's mothers claim their pensions. The value of child-rearing entitlements will differ significantly according to the date of the birth. Even in the event of identical „life history" as to the number of children and the time spent in gainful employment, the resulting pension level will be higher if the children are born after 31 december 1991. It could be questioned whether this kind of discrimination is acceptable under the Constitution, because the financial burdens are transferred to the future and must be borne by the subsequent generation anyhow. One might also question the financing mode and the kind of re-distribution it implies. It appears that there is no shift of the family/fertiliy related burdens from families/parents to childless persons. This is a general problem related to all family benefits financed from general tax revenue and not from a specific (social security) institution alimented by a special tax taken from the childless without maintenance obligations. However, there is no way to achieve intra-generational re-distribution from the childless to parents in an efficient way under a pay-as-you-go system, as there will always be simultaneous effects of inter-personal and inter-generational re-distribution.[46]

From an economic point of view, the concept of the current provisions on pension credits for child-rearing activities has been criticized as insufficient. It is argued that the pension system as such has been left unchanged and that the new policy measure does not establish meaningful incentives as to human capital investment which should be supported in view of a *complete*

[46] Cf. Horstmann, Kindererziehung und Alterssicherung, 1996, p. 259.

social contract between generations. The idea underlying this concept is to link the public debt which is implicitly incurred in any pay-as-you-go scheme to credit opportunities for the young, thereby funding future od-age security entitlements for the old with the human capital embodied in the next generation.[47]

The new feature of the German public pension system does not intend to influence fertility behaviour in Germany. Many attempts have been made to identify and isolate shifts in behaviour that can be traced to specific policy innovation. So far it has been impossible to assess the effectiveness and efficicency as regards the demographic impact of any one particular policy measure. This is the common fate of family policy measures in general. Studies on familiy policies suggest that overall fertility behaviour is relatively unaffected by familiy benefits (even if they have a high volume), and that such measures only have an effect on the timing or spacing of births. It is extremely difficult to make an assessment of isolated familiy benefits since there are always additional factors influencing fertility decisions, like housing policy or labour market policy etc.

Cross-country comparisons of fertility behaviour seem to suggest that no direct and irrefutable link can be established between policy outcomes and policy measures, either for families or for women as mothers. Rather, such policies may be one of any number of factors producing outcomes which may or may not be intended.[48] If one tries to assess the relative efficiency of certain policy measures there is some very slight evidence that measures to reduce the opportunity costs of children - which in general tend to be much higher than direct maintenance costs - might be more effective under a cost-benefit-analysis than measures aiming at reducing direct maintenance costs. This has been suggested with respect to measures intended to improve compatibility between work and family responsibilities, in particular provision of good quality child-care facilities.[49]

5 Alternative policy measures and proposals

5-1 Measures to balance resources and expenditure in the existing public pension system

As regards the impact of falling or persistently low fertility rates on the economic sustainability of the pension system, there have been a number of reforms aimed at cutting down pension expenditure and thus lessening the financial burden of the active generation. Special emphasis has been put on tightening the conditions of pensions under the public pension scheme. The primary aim has been - as in most western European countries - to **stop early exits** from the workforce by putting up the regular age limit for old-age pensions and by providing monetary

[47] Cf. Werding, Zur Rekonstruktion des Generationenvertrages, 1996, p. 427 ff.
[48] See e.g. Hantrais, Socio-demographic change, policy impacts and outcomes in social Europe, in: Journal of European Social Policy 1991, p. 291-309.
[49] As to the problem of assessing the efficiency of family benefits see Manzke, Kinderlastenausgleich versus verstärkte Einwanderung. Alternative Ansätze zur langfristigen Sicherung der Gesetzlichen Rentenversicherung, 1996, p. 156-184.

disincentives in case of early retirement before regular pensionable age has been reached. This policy implied above all the abolition of the special age limit for women which traditionally was set at the age of 60, 5 years below the age limit of men. This measure is rather controversial given the current labour market situation in general and the labour market position of older workers in particular. In practice the number of early exits according to special provisions remains impressive even nowadays when early exits entail a reduced pension. Another way to cut pension expenditure has been to change the parameters determining the amount of pensions (new definition of the pension formula) or the pension adjustment mechanism. Prior to the elections of 1998, the previous German government tried to introduce a so-called demographic factor as a new factor determining the amount of pensions into the pension reform for 1999. After the elections the new government suspended this part of the pension reform in order to prepare a structural reform of the public pension system.

As regards the financial basis of the pension scheme, the actual government has made attempts to increase the „natural resources“ of the public pension system by amplifying the number of contributors: Certain self-employed as well as particular dependent workers previously excluded by the lower income limit have been included into the social insurance scheme. Another policy aiming at securing the financial basis of the public pension system tries to increase the state contributions from general tax revenue (increase of VAT; creation of the new energy tax partly meant to meet the financial needs of the pension system). However, there are serious constraints to further increase State subsidies.[50]

Alternative proposals project an amplification of the types of income subject to compulsory contributions beyond income from wages. These proposals argue that in 1957, when the current system was designed, the legislator could not anticipate that other types of income[51] would spread among larger parts of the population. With respect to this evolution it becomes a problem of equity that the growing financial burden of the pension scheme is left to income from paid work - within the contribution assessment ceiling. Another proposal was to base the employers’ share of contributions on further value-adding items (profits, etc.) rather than on wages alone.

5-2 Policy proposals considering alternatives to the current public pension system

In addition to reform options intended to improve the existing system there are also proposals to introduce alternative forms of social security protection. Those alternatives are intended to replace the current public pension system by a different type of protection scheme.

The first approach wants to replace the current scheme by a flat rate **basic pension** (Grundrente) for every citizen, financed through taxes or earnings-related contributions, with additional private provisions on top of the public pension. The various proposals do not take

[50] Above all economic constraints because of the public debts (which have to be reduced to meet the so-called Maastricht criteria for the membership within the European Monetary Union).
[51] Property, capital assets, etc.

account of the implied contract between subsequent generations nor of the fundamental demographic problem. The financial burdens will be enormous and make the implementation of such a system seem rather unlikely.

The second approach proposes partial **capital funding** instead of the current pay-as-you-go-system as financing method. It appears that this financing method will lead to improved inter-generational equity as compared to the pay-as-you-go method (which puts the burden of financing the pension on a generation that has no responsibility for the financial problems of the pension system), but not not necessaryly to an improved re-distribution between childless and parents.

A third approach to change the system has been the proposal to introduce a parental pension (**Elternrente**).[52] It aims at providing a sufficient old-age protection for parents who have raised at least two children, and only a basic protection for the childless. The main effect would be that pensioners with children would be better off, pension entitlements of childless pensioners would be cut by half. Recently, a variation of the idea of a parental pension has been proposed as part of a new flexible old-age protection concept. It relies on the re-definition of the bench-mark standard pension. According to this concept, a full standard pension should be granted only to pensioners that have taken up parental responsibilities; childless pensioners would suffer a reduction in benefits.[53] Although parents would benefit from either measure, one has to question the re-distributional effects of such measures since there is no shift of the financial burden to the childless.

5-3 Alternative fertility-related policy measures within the public pension system

A number of family-(fertility-)oriented changes within the public pension system have been suggested as alternative to the current concept of child-rearing credits. There has been some debate on the viability of introducing special (lower) contribution rates (limited to employee's contribution) which would depend of the number of children in the family.[54] This type of policies aim at supporting parents covered by the public pension system during the active phase of parenthood. However, serious objections have been put forward against such policies. Lowering contribution rates would be a selective measure only in favour of parents

[52] Borchert, Die Berücksichtigung familiärer Kindererziehung im Recht der gesetzlichen Rentenversicherung, 1981, S. 225 ff.; Borchert, Renten vor dem Absturz,1993, S. 269 ff.

[53] Gallon/Bank/Kreikebohm, Flexibles System eigenständiger und leistungsbezogener Alterssicherung, in: Neue Zeitschrift für Sozialrecht, 1994, pp. 385-394; 444-450; 489-496.

[54] This proposal has a long history dating back to the discussion surrounding the pension reform of 1957. It has been taken up again in the 90s. For the different models see Schmidt-Kaler, Rentengesetzgebung als Instrument zur rationalen Steuerung und Rückkoppelung des Bevölkerungsprozesses, 1978; Müller/Burckhardt, Die 3-Generationensolidarität in der Rentenversicherung als Systemnotwendigkeit und ihre Konsequenzen, in: Sozialer Fortschritt 1983, S. 73 ff; Dinkel, Die Auswirkungen eines Geburten- und Bevölkerungsrückgangs auf Entwicklung und Ausgestaltung von gesetzlicher Alterssicherung und Familienlastenausgleich, 1984; Müller, Zu den Be- oder Entlastungswirkungen eines nach der Kinderzahl gestaffelten Rentenversicherungs-Beitragssatzes, in: Deutsche Rentenversicherung 1994, S. 322 ff; and recently, Schäuble, in Handelsblatt 15.10.1997.

subject to the pension insurance. This is in contrast to the German policy of universal family benefits. Besides, there are a number of problems related to the re-distributional effects of such a measure.

Further reform concepts try to modify survivors' pensions. The main idea is to make access to or the amount of survivors' benefits dependent on childraising activities. Child-raising would constitute the main eligibility criteria, but there could be variations in the benefit level according to the number of children raised. This model would imply an indirect recognition of childraising activities but limited to families based on marriage.

6 Conclusions

The question as to why and to what extent low fertility constitutes a problem for the German public pension system can be answered in different ways. Under the present institutional setting there are economic as well as legal reasons to respond to low fertility within the pension system.

The solution adopted under German pension law directly linked to fertility is the introduction of child-rearing credits since 1986. This measure clearly pursued the objective of providing a more equitable treatment of child-rearing periods within the pension system. It has been questioned, however, whether the policy represents an adequate response to the problems incurred by the present public pension system as regards the underlying contract between generations.

The institutional innovation involved establishes a positive material link between fertility behaviour and old-age security although it is not designed as a pro-natalist policy. The policy and its subsequent extensions have been strongly supported by the Federal Constitutional Court, the main rationale being the recognition of child-rearing activities as qualitative (although not quantitative) equivalent to gainful employment. The policy background must be seen above all as an expression of the constitutional mandate to protect families. More than once, the Federal Constitutional Court has urged the legislator to take due account of the disadvantages that families suffer in a society characterized by a persistently low fertility rate, emphasizing the legal/constitutional obligation to diminish those disadvantages.

Apart from definitely improving the old-age protection of mothers, it is difficult if not impossible to assess further effects of this policy measure. On the one hand, it has certainly contributed towards raising public sensitivity with respect to the „public“ value of raising children and provided more equity as to pension rights. On the other hand it cannot be denied that some aspects of the legal provisions might raise once again questions of constitutionality and that the effects on re-distribution between parents and childless remain questionable.