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Comparing Public Pension Systems in Portugal, Austria and Germany

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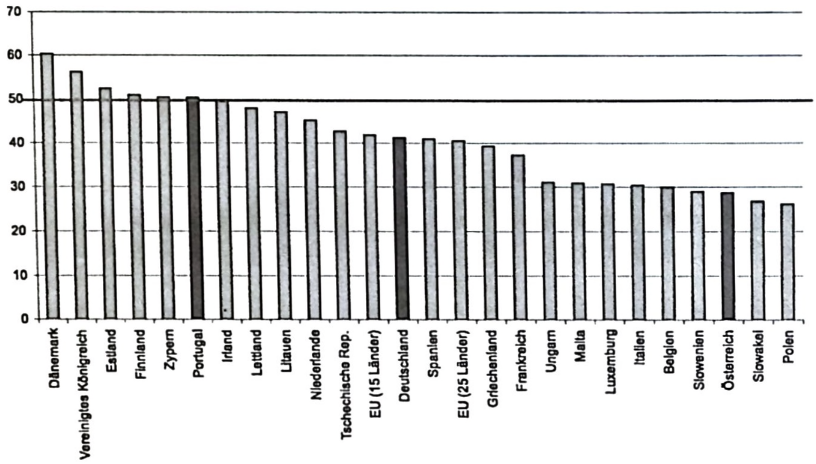
1. Background situation

According to international reports from the European Commission, the World Bank and the OECD, most of the European Countries face major challenges in relation to population ageing and the employment of older workers. Over the coming decades, the European Union will face a significant acceleration of demographic ageing due to the baby-boom generation reaching retirement age, continuing increases in life expectancy, and decreased fertility since the 1970s. However, all three factors combine to produce a major financial challenge for pensions systems over the coming decades when the number of pensioners will rapidly increase, and the size of the working-age population will diminish. There is a risk that the resulting increased old-age dependency ratio places an unsustainable financial burden on the active population in the future, while at the same time adversely affecting Europe's economic growth potential.

An obvious policy response to increased life expectancy is to raise the retirement age so that the balance between time spent working and time spent in retirement remains unchanged. However, most of the national reforms undertaken do not meet the requirements to achieve the targets set by the European Union (summits in Stockholm 2001 and Barcelona 2002) for the employment rate of older workers (50% by 2010 compared to 38.5% today) and for an increase in the effective retirement age by five years by 2010. In 2004 the labour market participation rate of older workers aged 55 to 64 varies from 60 percent to less than 30 percent in the EU-25 Countries (see Figure 1). Where as in Portugal the employment rate of older workers is close to 50%, and in Germany just over 40%, in Austria the corresponding rate is located at the lower end of the scale with 30% (blue columns).

1 *Deutsche Rentenversicherung Bund, Berlin.*

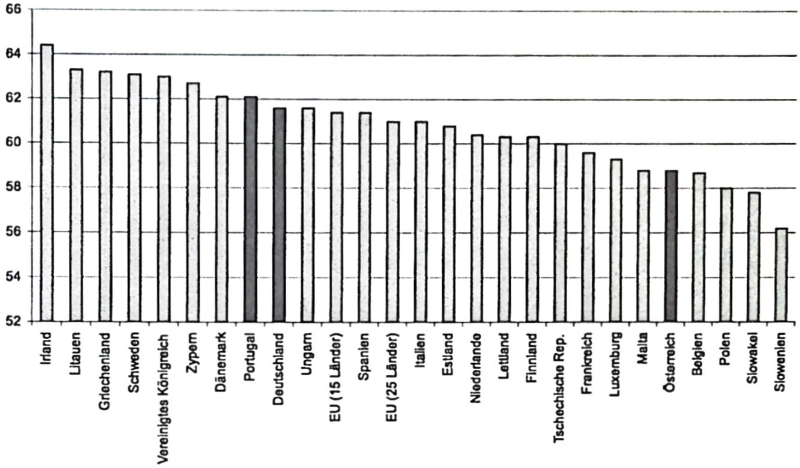
Figure 1: **European employment rates of 55 to 64-year old workers, 2004**



Source: EUROSTAT 2005.

Projections of public pension expenditure, which already foresee continued employment growth beyond 2010, still are predicting increasing public pension expenditures. Basically, the number of pensioners is continuously increasing, while the working-age population is growing at a significantly slower rate. This means that higher employment rates alone will not solve the problem of the financial sustainability of pension systems. Currently, most Europeans retire before reaching the statutory retirement age (see Figure 2). In the Smart-Region-States the corresponding average effective labour market exit age in Portugal is short beyond 62 years, followed by Germany exceeding 61 years, and Austria with less than 59 years (blue columns).

Figure 2: **Average effective exit age from the labour force, 2003**



Source: EUROSTAT 2005.

Coming back to policy recommendations one of the most important issues in this context is the design of the national social security system and the pension scheme in particular. To adjust the social security systems to the challenges of the demographic transition it is therefore inevitable to analyse their legal and monetary dimensions as well as the incentives involved. But comparing complicated social security systems in varying countries is consequently difficult, several methodological approaches are possible (chapter 2). On the basis of different criteria for a comparison of retirement-income systems a description of the national pension schemes in Portugal, Austria and Germany subsequently follows (chapter 3). Finally a general outlook and summary on demographic changes and sustainable pension systems will be given (chapter 4).

2. Methodological approaches

For a cross-country analysis of pension systems in the Smart-Region-States Portugal, Austria and Germany three different approaches can be distinguished (see OECD 2004):

1. **Institutional approach**: a description of structures, rules a parameters of a certain pension scheme is used, for example, by the Mutual Information System on Social Security (MISSOC) of the European Commission.
2. **Income-distribution analysis**: The OECD income-distribution analysis for example uses household survey data to asses the income of older people relative to the population as a whole.
3. **Financial and fiscal analysis**: Projecting pension expenditures into the future are regularly produced by the OECD for its Member countries.

Each of these methodological approaches is facing its own problems. Although institutional analysis is part of making international comparisons they are very difficult to use as a basis for policy decisions because of their detailed information. The major disadvantage of income-distribution analysis is the backward-looking: because of changing rules of the pension system in the past the economic well-being of future pensioners will be very different from current pensioners these income descriptions will fail. Finally financial and fiscal projections tend to focus on public pension spending, ignoring the range of resource transfers to the elderly. Furthermore they are based on aggregations, whereas the individual pension entitlement is important for political consequences and social adjustments. Taking the advantages and disadvantages into account using an modified institutional approach by summarizing measures from detailed rules of pension systems is the basis for the following comparison.

3. Modified institutional approach – Most important criteria

For a description and comparison of particular public pension schemes a set of different criteria is needed. Important criteria are the conditions to qualify for a pension (especially pension eligibility or retirement age and years of contribution), the calculation of pension entitlements and the group of claimants. Focusing on the financial basis of the public pension scheme the three analysed Smart-Regions-Countries differ in terms of contribution rates out of wage-earning or income form employment and benefits out of public expenditure based on general taxation (see Table 1).

Table 1: **Public pension system**

Portugal	**Austria**	**Germany**
	Group of claimants	
Employed persons and self-employed persons	Blue and white collar workers, persons in occupational training, equal other persons	Blue and white collar workers, persons in occupational training, some groups of self-employed persons
General Social insurance system	Pension insurance	Pension insurance
	Statutory retirement age	
Age 65 (max. 70)	Age 65 and 60 (for women)	Age 65
	Qualifying conditions	
15 contributory years (with earnings registration at least for 3 month of work) or 15 years of insurance	15 years of insurance in the last 30 years or 25 years of insurance or 15 contributory years	5 contributory years Age 63: 35 years of insurance (with reductions)
	Financing the Public pension system	
Employees: 11% of income Self-employed: 25,4% to 32% Employer: 23,75% of the cumulative labour costs State: additional payments for the general social security system, payments for social protection	Employees: 10,25% of income Employer: 12,55 of the cumulative labour costs State: additional payments for financial deficits, costs of social adjustments, care benefits	Employees: 9,75% of income Employer: 9,75% of income of the employee State: additional lump sum payments for non-contribution benefits (Federal State subsidies)

Whereas the social insurance system in Portugal covers employed and self-employed persons by a general social insurance program, the contributory pension insurance in Austria and Germany is historically based on blue a white collar workers and has been extended in several years for some groups of self-employed persons or person with equal status. In Germany statutory old-age pensions insurance is based on the principle of wage and contribution equivalence, which will lead to additional old-age pension entitlements. In Portugal – as in Austria as well – still special systems for miners, longshoremen, railway workers, fishermen and merchant seamen exist but will gradually be unified with the general system.

In the public scheme of Portugal, where the accrual rate varies with earnings, the public pension is redistributive, giving higher replacement rates to lower-income workers. In Germany exist a point system where workers earn points based on their individual earnings for each year of contributions. At retirement, the points are multiplied by a point value and thus converted into a monthly pension payment. All three retirement-income systems in Portugal, Austria and Germany are mandatory, based on defined contributions (DC-system).

Table 2: **Conditions for Early retirement and Invalidity pensions**

Portugal	**Austria**	**Germany**
	Conditions for Early retirement	
Age 55: 30 contributory years (with reductions) Age 50: miners Age 55: fishermen, merchant seamen, longshoremen, dancers (age 45 with reductions) Age 60: unemployed, airplane crew	Age 61,5: men with 45 contributory years Age 56,5: women with 40 contributory years	Age 60: - unemployed aged 58,5 and 15 contributory years - after 24 month of old-age part-time work - women after 25 years of insurance - disabled persons after 35 years of insurance
	Increase and reduction for Early retirement	
Reduction 4,5% (30 calendar years of earnings registration) at age 55. Without reduction for unemployed at age 60. Increase 10% (40 calendar years with earnings registration) until age 70.	Reduction 4,2% yearly, maximum 15%. Increase 4,2% yearly for max. 80% of the calculation basis for each year (max 91,76% in case of extending the pension able age).	Reduction of the accessing factor (1,0 for old age pensions) by 3,6% for each calendar year. Increase of the accessing factor (1,0 for old-age pensions) by 6% for each calendar year.
	Conditions for Invalidity pensions	
Waiting period 60 month of contributions or insurance	Waiting period 60 month of insurance in the last 10 years (framing time) Age 50: 180 month with contributions in the last 30 years plus 1 month of insurance for each living month (plus 2 month of the framing time)	Waiting period 60 month of insurance (in the last 5 years before invalidity with 36 month of compulsory contribution payments)

Incentives towards wage-earning activity for elderly employees are given by the fact that retirement before the statutory standard age-limit leads to percentage reductions from the amount of pension emerging from the usual pension's formula (see Table 2).

Claiming the old-age pension earlier (at age 55) is possible in Portugal when the claimant has completed 30 calendar years with earnings registration. The amount resulting from the calculation of the statutory pension is reduced by 4,5% for leaving early and will be increased by 10% for each additional year with effective earnings registration when working until the age limit of 70 years. In Germany shifting retirement beyond the statutory standard age-limit is rewarded with a percentage pension bonus for delayed retirement of 6% for each year. The reductions in old-age pensions applying to early retirement are 3,6% for each year of retirement before reaching the age of 65. All these pension reductions or increases remain effective during the whole term of retirement. In Austria workers over the age of 57 still can receive a disability pension if they are unable to perform their former job – this type of "own-occupation" assessment has been abolished in Germany in the year 2000. To make longer economic activity more attractive, the actuarial addition per year of later retirement (as well as the deduction for earlier retirement) was increased to 4.2% of the pension in Austria.

Since existing pathways into early retirement are still used extensively, changing attitudes of employers and employees are one of the most important factors facing the challenges of demographic change. In this context, sustainable finance policy, at least as a matter of fairness between the generations and the challenges posed by the demographic trends, is inevitable.

4. Summary and Outlook

A comprehensive approach is needed to encourage older workers for an extension of their labour market participation period. Therefore the pension system needs to be strengthened and complemented by reform of early retirement conditions and disability pensions. This may only be successful if a number of changes in active labour market policy and employment regulations to enhance the employability of older workers are accompanied.[2] Policy recommendations may therefore include:

- Adjusting the retirement age according to the raise in life expectancy
- Using disability pensions only for people unable to work
- Improving targeted tax cuts for employing older workers with low chances of reintegration, i.e. older unemployed workers with low or obsolete skills[3]
- Improving education and training opportunities for older workers

2 For recommendations see Commission of the European Communities (2003b)

3 The last labour market reforms in Germany include some of these incentives in this direction; see Stecker (2004a) and Stecker (2004b).

- Considering financial incentives for employers to invest in injury prevention at the workplace

Apart from labour market reforms for raising employment rates, strategies are built on budgetary consolidation and reforms of pension systems to cope with the challenges of increases in life expectancy and decreased fertility. Adequate and sustainable pension systems – as has been underlined in the European Councils of Lisbon, Stockholm and Barcelona – have to be adjusted to an ageing population and an ageing workforce.[4] To lower the poverty risk of older people pension systems can build strong redistributive elements, as has been described in this article for the retirement-income systems in Portugal, Austria and Germany. These statutory schemes (can) respond – more or less – well to the challenge of providing pensions for atypical (part-time, temporary, self-employed workers) and mobile workers. As the financial sustainability of pension systems is a necessary precondition for the fairness between generations, and an increasing of the effective retirement age would lower the expected increase in pension expenditure in the future, further efforts in the three Smart-Region-Countries are needed to address the consequences of the baby-boom generation on pension systems already in the next few years.

4 For details see OECD (2004) and Commission of the European Communities (2003a).

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For details on concepts of the pension schemes and current reforms in Portugal, Austria and Germany see:

- Different OECD-publications, http://www.oecd.org.
- Latest National Strategy Reports on old-age pension provision reported to the European Commission, http://europa.eu.int/comm/employment_social
- Different MISSOC-publications, Mutual Information System on Social Security of the European Commission, http://europa.eu.int/comm/employment_social/social_protection/missoc
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- German Pension Insurance, Deutsche Rentenversicherung Bund, http://www.deutsche-rentenversicherung.de
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- Instituto do Emprego e Formação Profissional (Employment and Vocational Training Institute, IEFP), http://www.iefp.pt
- Ministério do Trabalho e da Solidariedade Social (Ministry for Labour and Social Solidarity, MTSS), http://www.mts.gov.pt