Country Report

SWEDEN

Current pension system: first assessment of reform outcomes and output

By
Igor Guardiancich

European Social Observatory
www.ose.be

Research Project
"ASSURER UNE PENSION ADÉQUATE DANS UN CONTEXTE EUROPÉEN"
Supported by the
Belgian Federal Public Service Social Security

May 2010

Een onderzoeksproject uitgevoerd door
het Observatoire social européen (OSE)
in opdracht van
de Directie-generaal Sociaal Beleid
van de Federale Overheidsdienst Sociale Zekerheid.

Un projet de recherches de
l'Observatoire social européen (OSE)
à la demande de
la Direction générale Politique sociale
du Service public fédéral Sécurité sociale

SWEDEN

The Institutional Architecture

The old Swedish pension system combined both Beveridgean features – in the form of a universal tax-financed flat-rate basic pension (*folkpension*) and pension supplements – and a Bismarckian insurance system – the earnings-related contribution-financed defined-benefit *allmän tilläggspension* (ATP) – that guaranteed very generous and encompassing protection against old age risk. The ATP system entered serious fiscal difficulties from the 1980s, when a 10-year long reform effort started. This led to one of the most radical pension overhauls in OECD countries. The new system is multipillar, whose first pillar combines a minimum flat-rate guarantee pension (*garantipension*), a Notional Defined Contribution earnings-related pension, the income pension (*inkomstpension*) and a private fully-funded premium pension (*premiereservsystem*). Quasi-mandatory occupational pensions top up the schemes above.

The reform was only possible due to the existence of National Pension Funds (*AP-Fonden*), so-called 'buffer funds', which invested the ATP surpluses during the years, thereby reaching the effective capacity to cover 5 consecutive years worth of benefits.

The reform achieved three important goals: i) it stabilized the long-term financial prospects of the Swedish public pension system; ii) it introduced wage-related indexation, thereby stopping the erosion of the ATP benefit ceilings; iii) by calculating the assessment base over an individual's life-time, it eliminated the perverse redistribution of the best-year formula.

The **first (state and mandatory) pillar** includes three tiers. The zero tier, the guarantee pension supplanted in 2003 the old basic pension and related supplements. It is universal, tax-financed, flat rate and indexed to prices. Eligibility is based on residence (40 years) and age (for people over 65). It is either meant as a source of income for people who do not qualify for public pension or as a supplement for low-income pensioners. Means-testing applies for income earned through the income pension, premium pension, supplementary pension (*tilläggspension*), widow's pension (*änkepension*); but not through by income form capital, occupational pensions (*tjänstepension*) or private pension insurance. In 2009, the full guarantee pension amounted to SEK 6,777 per month for a married persona and SEK 7,597 for a single one. The income ceilings were SEK 10,959 per month for a single person (around a quarter of gross average earnings) and SEK 9,713 per month for a married one. For those who do not meet this requirement (usually immigrants), there is a special maintenance allowance; low-income pensioners are also eligible for the pensioners housing supplement (BTP) that covers 93% of housing costs up to SEK 5,000 per month for a single pensioner.

The first tier is the income pension (ATP), a very sophisticated Notional Defined Contribution system introduced in 1998 for the cohorts born after 1954 (a mixed system applies for those born between 1938 and 1953) and which implies taking into account lifetime income. It is financed through a total contribution rate of 18.5% of the pensionable pay, i.e. the gross wage minus the 7% employee contribution for pension insurance. Of these, 16% flow into ATP and 2.5% to the funded premium pension. Hence the actual contribution rate on gross wages is 17.21% in total, 14.88% to ATP and 2.33% to the premium pension. Contributions are paid up to a ceiling (111% of the gross wage in 2006), employers pay a tax equal to their contributions above that ceiling and this flows into the general budget. The state (sometimes together with the claimant) covers the contributions for inactive periods during childrearing, military service, higher education, sickness and unemployment.

The individual accounts are valorized according to per capita wage growth - an 'income index' (*inkomstindex*) based on changes in average pension-carrying income for wage-earners aged 16-64 (hence the divergence with total wage growth, e.g. as in the case of a declining workforce, may create fiscal imbalances). The retirement age is flexible and one can retire at

any time after 61, however, collective agreements and employers' attitude hinder employment after 67.
The annuity is calculated with respect to an individual's age and is based on gender-neutral mortality tables (hence there is redistribution to women). The rate of return imputed to the annuity is 1.6% and then adjusted for deviations with respect to wage growth (this provides somewhat higher initial annuities and smoothens out the pension prospects).
Due to the deficiencies in valorization, there is also a balancing mechanism. If assets (the buffer fund plus the estimated value of assets in the form of contribution revenues) fall below liabilities (accrued notional pension capital and capital value of outgoing pensions), then indexation of pensions in payment and returns credited to notional accounts are reduced by the ratio of assets to liabilities. In 2008, the ratio fell for the first time under unity, to 0.9672, thereby triggering the mechanism. If the ratio, instead, exceeds 1.1, the built up reserves may be redistributed to the participants.
The second tier, is the fully-funded premium pension, financed by the remaining 2.5% of total contributions. Contributions are collected by the National Tax Board and managed by the Premium Pension Authority (PPM, *Premiepensionsmyndigheten*). This acts as a clearinghouse, managing individual contributions and disbursing annuities. This severs any direct contact between the pension funds and its individual members. New members choose between circa 800 funds, including a public default fund, the Premium Savings Fund, (*Premiesparfonden*) for those who do not make an active fund choice. Annuities are either fixed with a minimum rate of return of 3% or variable. After death, assets are not inheritable and are transferred to the birth cohort. At the end of August, the total market value of investments in the PPM was SEK 283 billion (EUR 28 billion), of which the default fund holds the largest share with a market value of SEK 74.53 billion. Notwithstanding the large information campaign in the early 2000s, only 10-15% of new labour market entrants make an active choice and do not end up insured in the default fund.
The **second pillar** consists of supplementary quasi-mandatory occupational funded schemes. These are based on collective agreements and cover a staggering 90% of employees. The contribution level is usually between 2 and 5% of wages. The plans are either defined-contribution or a defined-benefit. The four main plans are meant for: white-collar workers (*industrins och handlens tilläggspens ion*), blue-collar workers (STP), central government (*statlig tjänstepension*) and local government (*communal tjänstepension*). Some of these schemes allow for retirement as early as at age 55, but frequently beneficiaries start claiming them at age 65.
Finally, the **third pillar** consists of voluntary, supplementary pension schemes, is a voluntary accumulation for old age to pension funds or insurance companies. Its growth is favoured by tax incentives.

Information needs

Just before launching the new system of individual accounts, the Swedish government launched a 3-year information campaign aimed at prospective participants. The media and the web were extensively used. Members received first annual account statement for the pension scheme, the 'orange envelope', together with a brochure explaining the system. Such campaign is crucial to increase financial literacy and individual responsibility. Each orange envelope contains the projections for the first pillar benefits (both the NDC and individual accounts) if the person retires at 61, 65 and 67. The PPM also sends an annual statement on returns and investment in the premium pension.

The Administrative Structure

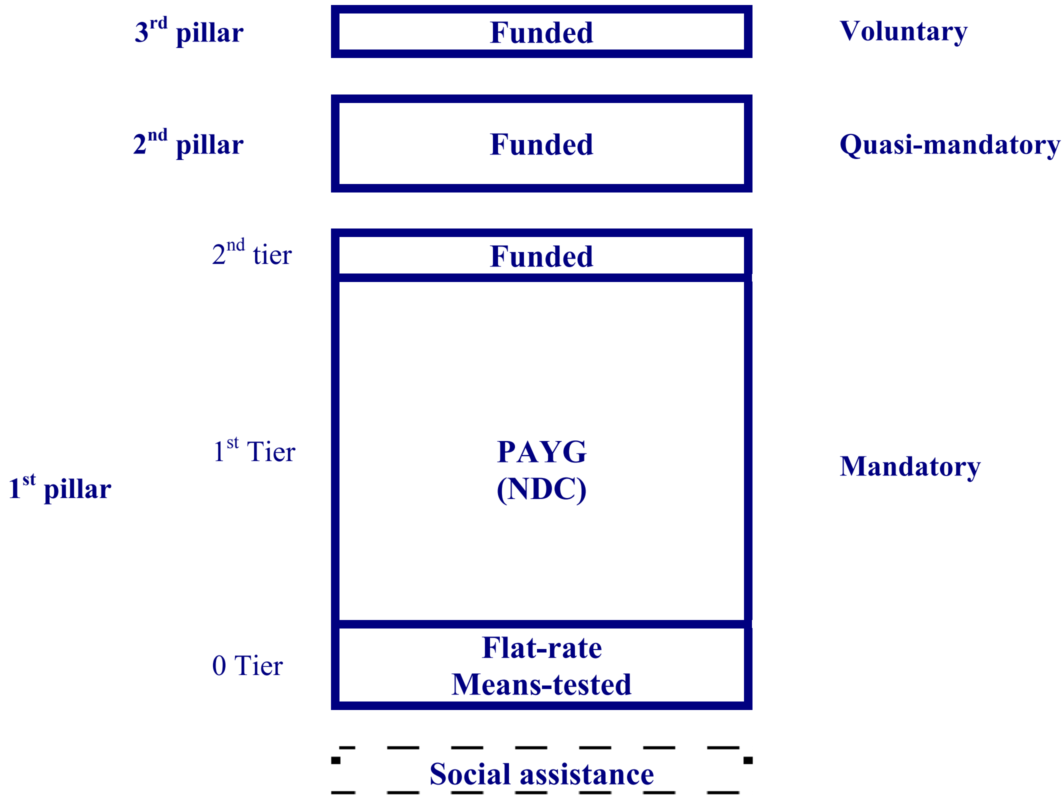
The public pension system is under the responsibility of the Ministry of Social Security and Labour. The National Insurance Board (*Försäkringskassan*) administers the guarantee pension and the income pension. The Premium Pension Authority (PPM) manages the individual accounts and annuities in the premium pension. Private managers administer the funds. All non-insurance based items have been moved to the state budget (contributions for years outside the labour market, the guarantee, disability and survivor pensions). The National Tax Board collects contributions for income-related schemes.

Assessment and Future Challenges

The Swedish system is often considered as one of the most stable and reliable in the world. The introduction of the NDC system will on average decrease replacement rates, but this should not determine any more risks for the elderly, due to high coverage (of occupational pensions as well), extensive pension credits, means-tested benefits and very high labour participation rates.

There are, however, two sets of recommendations that can be given. The first set relates to ways to improve the existing system. The major problem is one of awareness. Information campaigns should be a constant component of one's adult life. In fact, even the financially literate Swedish population fails to understand the underpinning mechanisms of the NDC system and the importance of making an active choice when selecting a pension fund. The second set is instead aimed at would-be reformers who aim to replicate the Swedish system abroad. Sweden had a number of favourable circumstances (broad cross-parliamentarian consensus, 10 years of debate, wealthy AP Funds and a very active labour force) that rendered such radical reform feasible. Not many countries around the globe enjoy such advantages nowadays.

Figure 1 The Main Pillars in the Swedish Pension System



1st Pillar, universal coverage (0 tier tax-financed, 1st tier public and contribution-financed, 2nd tier state-regulated and privately managed, contribution-financed);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in Sweden

Contribution rates	
Total (1st pillar)	18.5%
1st tier	16%
2nd tier	2.5%

Supplementary schemes	
Contribution rates	3-5%
Coverage (of employees)	90%
Assets in EUR bln (2007)	165.00
Taxation	Exempt Taxed Taxed
Investment principles	Quantitative restrictions

Theoretical replacement rates	Gross			Net
	1st pillar	2nd pillar	Total	Total
2005	53.0	14.7	67.7	71.4
2050	40.4	15.4	55.8	56.7

SILC income 2004	Total	Male	Female
Relative income of 65+	0.797	0.865	0.754
Aggregate rep. ratio	0.581	0.605	0.543

Eligibility retirement age	
Old age	Flexible retirement from 61 for both women and men
Early retirement	Allowed in some occupational schemes
Deferred retirement	No upper limit

Indexation	
Guarantee pension	Prices
Income pension	Per capita wage growth

Public pension spending (as % of GDP)	2004	2020	2050
	12.9	12.8	13.9

Bibliography

Anderson, Karen M., and Ellen M. Immergut. 2007. Sweden: After Social Democratic Hegemony. In *The Handbook of West European Pension Politics*, edited by E. M. Immergut, K. M. Anderson and I. Schulze. Oxford and New York: Oxford University Press, 349-395.

EFRP. 2009. *Annual Report 2008*. Brussels: European Federation for Retirement Provision.

EPC. 2006. The Impact of Ageing on Public Expenditure: Projections for the EU25 Member States on Pensions, Health Care, Longterm Care, Education and Unemployment Transfers (2004-2050). Brussels: The Economic Policy Committee and Directorate-General for Economic and Financial Affairs.

European Commission. 2007. Joint Report on Social Protection and Social Inclusion: Social inclusion, Pensions, Healthcare and Long Term Care. Brussels: European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities.

Haverland, Markus. 2007. When the Welfare State Meets the Regulatory State: EU Occupational Pension Policy. *Journal of European Public Policy* 14 (6): 886-904.

Könberg, Bo, Edward Palmer, and Annika Sundén. 2006. The NDC Reform in Sweden: The 1994 Legislation to the Present. In *Pension Reform: Issues and Prospects for Non-Financial Defined Contribution (NDC) Schemes*, edited by R. Holzmann and E. Palmer. Washington, DC: The World Bank, 449-461.

MISSOC. 2009. *Mutual Information System on Social Protection in the Member States of the European Union, of the European Economic Area, and Switzerland. Situation on 1 January 2009*. Brussels: European Commission.

OECD. 2009. *Pension Systems at a Glance: Retirement-Income Systems in OECD Countries*. Paris: Organisation for Economic Co-operation and Development.

SPC. 2006. Current and Prospective Theoretical Replacement Rates. Brussels: The Social Protection Committee of the Directorate-General for Employment, Social Affairs and Equal Opportunities.