



# *The Swedish Pension Reform – at Half Time*



The Swedish Trade Union Confederation

On the cover:

Torbjörn Burvall, 54 year, IF Metall Norra Västerbotten Local 3  
Miner in Renströmsgruvan, Boliden Mineral AB

© The Swedish Trade Union Confederation (LO) 2011

Photo: Lars Forsstedt

Graphic form: LO

Original: MacGunnar – Information & Media

Print: LO-Tryckeriet, Stockholm 2011

ISBN 978-91-566-2704-0

LO 11.04 500

# The Swedish Pension Reform – at Half Time

Introduction	4
The new national pension system in brief	6
How much will the pension be?	8
Conclusions	10

# Introduction

“THE SWEDISH PENSION REFORM at half time” is based on the formal positions taken by LO (Swedish Trade Union Confederation) in consultation responses in connection with the reform of the national pension system. LO supported the state pension reform. This was an important choice of position both for the organisation and for the legitimacy of the reform. It is good to have broad political consensus on a regulatory framework for pensions, which in principle must last for a long time to come. Pensions are long-term. It is important for those covered by the pension system that it can be expected to stay in place for many decades.

The old pension system was a defined benefit plan and it was feared that it would not hold up in the future. Consequently, one point of the new pension system is that it is self-financed in that total assets and liabilities in the system must be balanced. Everything paid in must be paid out, neither more nor less. This is done by allocating inheritance gains, adapting life expectancy denominators to the expected average lifetime and finally having a braking mechanism. The pension system will therefore always survive, but how will it be for the pensioners?

The effects of life incomes and increased life expectancy have not yet had their full impact. The new pension system is being phased in successively and we have now reached the half-way point. People retiring today will receive about half their pension from the new system and only around 2020 will the new system be fully in force. It is therefore appropriate at

this point to evaluate actual pension outcomes. There is sufficient reference data and there is still time to rectify any deficiencies. Consequently, it is time to review LO's established opinions about the national pension and recall what did not gain the support of the politicians who decided on the pension system.

Foreigners make study visits to Sweden and ask: "Why doesn't LO protest against the pension reform like trade union organisations are doing in other European countries where pension reforms are proposed? Why don't you demonstrate like in France, why don't you call a general strike like in Greece?" The answer is that we are pragmatic. We understand that it is impossible to receive more pension than people are prepared to pay for, that the system cannot include magic. For pensions to be paid out, money must be paid in. In addition, we think it is a good thing to have a well-developed national pension system.

Expectations as to the size of our pension must be weighed against how much we are prepared to pay towards pensions while we working. We must also fund childcare, schools, health and social services, unemployment and sickness insurance, studies, elderly care etc. It's about having a realistic view of what can be demanded.

### *Life expectancy denominator*

The life expectancy denominator reflects a statistical expectation of remaining life for each person's age group, at the time the pension is drawn. The life expectancy denominator is the same for women and men. In that way the pension is evenly distributed over the years of retirement.

# The new national pension system in brief

THE NATIONAL PENSION is the pension you are entitled to by law. It is now for the most part a defined contribution system. Pension rights arise through the payment of contributions. The value of the paid-in contributions year by year is indexed and added up to a pension capital. Every year inheritance gains are also added to the pension capital. When you start to draw your old-age pension the pension capital is divided by the life expectancy denominator applicable to your age group. The life expectancy denominator is determined by how long on average you are expected to live as a pensioner and is the same for men and women.

## *Inheritance gains*

When a person dies, payments to the pension system cease. The pension contributions already paid in for the deceased person, or the money remaining in the pension account (if the person had started to draw pension), is distributed in the form of inheritance gains. These are distributed among the survivors in the same age group.

The national pension consists of three parts:

**Income pension:** the part of the old-age pension in which the premium, which is 16 per cent of the pensionable income, is paid into a pay-as-you-go system.

**Premium pension:** the part of the old-age pension in which the premium, which is 2.5 per cent of the pensionable income, is invested in funds. The premium pension is a funded system. Each individual has their own account balance, the size of which partly depends on the premiums paid in for the premium pension and partly on the performance of the funds in question. Each individual is able to make their own choice of funds and change funds at any time. From the date of retirement it is possible to choose a with-profit annuity for the premium pension with traditional management.

**Guarantee pension:** the part of the national old-age pension that is paid out to a person who has no income-based old-age pension or whose income-based old-age pension does not exceed a given amount. The guarantee pension is funded through tax revenues. The right to guarantee pension is earned by being resident in Sweden. The amount of the guarantee pension depends on whether a person is married or unmarried.

The new pension system applies fully to people born in 1954 or later.

## How much will the pension be?

INDIVIDUALS ARE NOW LIVING longer than was expected when the pension reform was implemented. This means that the life expectancy denominator has risen and the inheritance gains have fallen. The pension for a 65-year-old will therefore be lower than was expected in 1995. Under the conditions prevailing then, a full-time employed industrial worker after 45 years at work could have received 62 per cent of final salary in national pension with the new pension system in full operation.

Today, in 2011, the average life expectancy is two years longer than it was in 1995. Under these new conditions the pension will be considerably lower and only be 54 per cent of the final salary. To get a pension of 62 per cent of final salary under today's conditions a person would have to work two years more and retire at the age of 67. Earned pension rights and inheritance gains will then be higher, at the same time as the life expectancy denominator will be lower.

Because an automatic braking mechanism is now temporarily in force in the pension system, the pension is expected to be about 52 per cent of final salary. Without a brake the pension would be 55 per cent of final salary. An industrial worker who did not work the full time but received a disability pension at age 60, for example, is expected today to receive a pension that is only slightly lower, that is 51 per cent and 54 per cent of final salary respectively.

It is of course gratifying that the average life expectancy has increased by two years since 1995. This does not create any great general problem for the size of pensions, because with a

higher life expectancy it should also be possible to work longer. The great problem is instead that the spread of the average life expectancy is great and this spread has increased. Improved health and longer life expectancy are average improvements that are not enjoyed by everyone. For large groups there has been no change, which means that they are not able to work more years.

But the greatest problem is that many people today cannot even work until their 65<sup>th</sup> birthday. Those with a low standard of education on average have a considerably shorter life expectancy than those with higher education. This is probably mainly because those with less education work in an environment that wears them out to a greater extent than is the case for those with higher education. They also leave the labour market considerably earlier than those with higher education.

# Conclusions

ALL THE SAME, it was right to introduce the life-income principle, which is fairer than, for example, basing pension rights on income for a certain number of years. The rules in the old pension system favoured people with a short working life and irregular income, regardless of the reason. No difference was made between those who had a low income because they had taken care of children or been ill, and those who had not worked, or done unregistered work.

In the new pension system it is clearer which behaviours and circumstances are to be jointly financed for reasons of distribution policy. LO still considers that this principle is correct. But since the possibilities of working throughout life are unequally distributed, more measures must be implemented.

- A better work environment, continuing training, rehabilitation and more secure employment are necessary so that more people can decide to work longer and thus improve their old-age pension. The right to be able to work longer and longer is a matter of everyone's right to a full working life. The physical and mental burden at each workplace should be such that it is possible to work there and in the same occupation for an entire working life.

Unfortunately these measures take time before they have a noticeable effect. So further measures should be implemented that give an immediate effect. In recent years the policy has been to only reward people who are able to work longer. The right to continue working has been extended to the age of 67

and there are discussions about extending it to the age of 69. Major tax relief has been granted to people working after the age of 65. The tax benefits are almost double and employers' contributions cut by half. For people who are unable to work longer there have only been changes for the worse and it has become more difficult to get a disability pension. So it is time to do something positive for these groups, above all those hit hardest by the increase in life expectancy.

People who qualify today for a disability pension have their pension rights calculated on the basis of an underlying income. This means that the pension will only be slightly lower as long as it is a matter of a limited number of years. There are, however, problems with today's system in that the right to disability pension ceases at the age of 65. At that time a person must take old-age pension.

- If everyone is to work until the age of 67, the right to disability pension and underlying income should apply to the age of 67, too. Then people on disability pension will also be able to benefit from the lower life expectancy denominator and higher inheritance gains.

The efforts to achieve a sustainable working life for everyone must be intensified so that the right to work until the age of 67 becomes a reality for more people.

In the event of sickness or unemployment it is not sufficient that the compensation paid counts as pensionable income, since it is considerably lower than the income on which the compensation is based. LO believes that people affected by unemployment or sickness should not need to have a worse old-age pension than if he or she had continued to work.

Sickness and unemployment are unequally distributed. The LO groups are the people who to a greater extent than others

are supported through these insurance systems. If life expectancy increases, and thereby the life expectancy denominator, then absence from work through no fault of one's own due to sickness or unemployment should also give pension entitlement for as long as one is legally entitled to keep working before retirement.

- For that reason, underlying income should also be pensionable, when a person is receiving sickness benefit and unemployment benefit.
- For the underlying income to justify its name also over a few years, it should be adjusted upwards by income increases and not by price increases as is the case today.

Has the pension reform led to privatisation and individualisation of the responsibility for supporting oneself when working life is at an end? It is not reasonable that the individual premium pension component contains such an abundance of eligible funds, and thus a large spread in the actual pension outcome, even among people with similar working lives and incomes, just because they have chosen different funds.

- LO therefore advocates coordinated administration of the premium pension, and the introduction of the alternative of choosing with-profit insurance instead of pure unit-linked insurance in the premium pension system.

It is of course possible that a majority of people in work will want to retire at the age of 65 despite increased average life expectancy. At the same time, they want a pension that is as high as if they had worked until the age of 67. In that case there are two solutions. One is not to do anything and hope for a favourable stock market trend. If the stock market goes really well, premium pensions could give an appreciable ad-

dition to the national pension. Since the start in 2000 this has not yet happened. Of course this is too short a period on which to make a proper evaluation, but up to now developments indicate that it is a risky strategy to set one's hopes on the stock market.

The other solution is to increase pension contributions. On the basis of current conditions, the pension contribution would need to be increased from 18.5 per cent to 22 per cent to give the desired pension. But that is what applies today. Population forecasts show that with great probability, average life expectancy will continue to increase in the future. This means that in future if you want to keep the age of retirement at 65 and have a national pension that is about 62 per cent of the final salary, a contribution of 22 per cent will not be enough. It will then need to be raised even more.

An increase in pension contributions from 18.5 to 22 per cent restricts the scope for wage increases correspondingly. This gives higher pensions but does not solve the injustice in the wide spread between groups as regards capacity to work when older. With a higher contribution everyone will have a higher pension, even those who today can retire later. In that an increased contribution raises the pension for everyone, it will cost more than the improvement in the public insurance systems, which only cover those who are unable to work until they are 67 years old.

The contribution level is also significant for how extensive the contractual and private pension solutions need to be. A higher national pension level means that the contractual and private contribution levels do not need to be as high in order to ultimately achieve the desired pension conditions.

To deal with the problem of the wide spread in working capacity after the age of 60, the appropriate course is to invest

in better working conditions. If instead a general rise in the pension level is what is wanted it is more appropriate to raise the contribution level. It will take time before both these measures have the desired effect on pensions. Changing conditions in the labour market so that everyone can and wants to work longer is both a long-term and an uncertain venture. But an increase in contributions is also a long-term venture. According to the life income principle it is only the payments made after the contribution is increased that can raise future pensions. The full effect is only achieved after a whole working life, in other words after 40–45 years.

Even if there is a broad political majority for the current pension system, it must be possible to continue discussing the parts that can be improved, so that the pension system fulfils its purpose of giving reasonable income security to older people and contributing to solidarity between different groups in society. In that the number of years worked is so central to the pension system, such a discussion must include what can be done to enable everyone to have as equal an opportunity as possible to earn good pension benefits. It takes a long time before changes in the pension system and working life have an effect on pensions. So the discussion must start now. Pending the results, the conditions of the public insurance systems can be changed, which will have an immediate effect.





## ***The Swedish Pension Reform – at Half Time***

“The Swedish Pension Reform – at Half Time” explains and discusses the new pension system in Sweden. The old system was a defined benefit plan and it was feared that it would not hold up in the future.

The new pension system is self-financed in that the total number of assets and liabilities in the system must be balanced. Everything paid in must be paid out, neither more nor less.

The pension system will therefore always survive, but how will it be for the pensioners?

**[www.lo.se](http://www.lo.se)**

ISBN 978-91-566-2704-0