Retirement Pensions: National Schemes, Social Insurance and Private Funds

Sweden

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I GENERAL ASPECTS OF THE SWEDISH SOCIAL SECURITY SYSTEM

1. Universal Coverage

The Swedish Social Security system has a very homogenous character. The statutory system covers the entire population. Salaried staff, workers and public servants are covered by the same universal system. Even the self-employed are covered by the general system and insured against all risks, including unemployment and work injury, in the same way as employees. There are occupational “top up” schemes based on central collective agreements covering practically all employees.

2. Material Scope and Basic Principles

The statutory system covers all the “classical risks” in European social security, old age, invalidity, work injury, sickness and unemployment. Work injury benefit and unemployment benefit are regulated in separate statutes. Unemployment benefit is administrated by special unemployment funds related to the trade unions, but financed in the same way as other social security benefits. Maternity benefit is replaced by a parental benefit that awards benefit as a proportion of lost earnings to the parent staying at home with the child. The basic principle in the Swedish social security system is the Principle of replacement of lost earnings, where the amount of benefit is calculated as a percentage of previous earnings. The general level of compensation for short-term benefits in the statutory system is 80 percent. The supplementary occupational schemes add another 10 percent to the sick benefit. The Swedish social security system is oriented towards the individual, not the family. There are no increases for dependant family members and no widow’s pensions.

Important non-contributory benefits are child benefit, housing benefits to families with children and to pensioners, special benefits to lone parents, study grants and income support constructed as a guaranteed level of income for a certain kind of household. All housing benefits are income-related, i.e. they are only awarded to households below a certain level of income. Child benefits and study grants are not related to family income.

3. Financing

The statutory social security system is mainly financed through employers’ contributions that are constructed as a payroll-tax. Contributions are paid even on the pay that is above the upper earnings limit for benefits awarded. The current rate of contribution (including contributions to the pension scheme) is 33 percent of the payroll. The contribution rate for self-employed is about the same, 31 percent. The social security contributions in general (but not the contributions to the earnings-related pension scheme) are treated as a part of the state revenue and not separated from other state revenue.

II GENERAL ASPECTS OF THE NATIONAL PENSION SYSTEM

1. Basic principles and objectives

A new statutory old age pension scheme was adopted in 1998. The previous scheme consisted of two parts, a basic pension (folkpension) awarded to all residents and a general additional pension amounting to 60 percent of previous earnings up to an upper earnings limit and linked to a price index. The scheme was a defined benefit scheme. Qualifying time for a full additional pension was 30 years and the amount of pension was calculated on “the best 15 years”.

The principal part of the new pension system is *the Earnings-based pension,* which is a defined contribution scheme based on lifelong average earnings. An amount equivalent to 18.5 percent of pensionable earnings and pensionable amounts (see below) is transferred to the pension system. 16 percentage points go to a Pay as you go (PAYG) system. The remaining 2.5 percentage points are invested in individual accounts in a prefunded system.

There is no guaranteed level of compensation in the earnings-based scheme. Instead, pension rights and pensions in the PAYG system are linked to an earnings index reflecting the general earnings trend and calculated on the basis of average life expectancy at the time of retirement. The pensions in the prefunded system are linked to the value of the fund(s) where the contributions have been invested.

Within these frames the new earnings-based pension is more closely related to previous work than the former additional pension. Pensions are calculated on average lifelong earnings. There is no maximum qualifying time. The longer you work, the higher pension you get. All earning years give the same right to pension. There is no rule of “the best working years”.

Two basic principles can be recognised in the new earnings-based pension. The sum total of pensions to be paid is determined by the economic and demographic development, a principle that can also be regarded as a matter of fairness between the generations. The distribution of pensions among the pensioners in the same generation is mainly decided by the principle of pension as a reward for previous work.

There are, however, also strong elements of solidarity in the earnings-based pension system. The payroll-tax, where contributions are paid on salaries above the upper earnings limit, has a redistributive effect. Social security benefits like sickness benefit and unemployment benefit give rise to pension rights though no employers’ contributions have been paid on such benefits. Pension rights are also awarded for certain periods in life, during which the claimant has no earnings or lower earnings than normal, childcare years, study years and periods of national (military or non-military) service. In these cases pension rights are calculated on fictive earnings, the pensionable amount. These redistribute features apply to the PAYG system and the pre-funded system alike. The state is responsible for that the necessary contributions for such periods are paid into the pension schemes.

The second pillar of the national pension system is the Guarantee pension. The old “folkpension”, which was the original part of the Swedish pension system and awarded as a basic pension to everybody, has been replaced by a guaranteed pension, awarded as a minimum benefit only to those who have not obtained an earnings-based pension that amounts to the guaranteed level. Thus the previous basic pension has become the supplementary pension, while the previous earnings-related “additional” pension has become the basic system. The reversed roles can be interpreted as an ideological shift. The subsistence level of the Guarantee pension is however the same or a little higher than the old folkpension. The aim of the Guarantee pension is to provide a reasonable social minimum to all pensioners.

The third pillar in the Swedish pension system consists of *the occupational pensions*, which are designed as top up schemes in relation to the statutory scheme. Practically all employees are covered by one of the collective systems for occupational pensions that are based on collective agreements on the central national level. There are four main schemes, one for state employees, one for employees in the municipal sector, one for non-manual workers in the private sector and one for manual workers in the private sector. The schemes for the employees in the public sector and for non-manual workers in the private sector are of great significance for high-salaried staff since pensions are calculated even on parts of the earnings above the upper earnings limit in the statutory pension scheme.

The occupational pension schemes have previously been defined benefit schemes based on “final salary”. The level of compensation together with the statutory pension has ranged between 70 and 80 percent of final salary. Full pension has normally required 30 years of employment and only years with at least 40 percent of full time employment were counted as qualifying years.

These occupational schemes have been or are now being renegotiated because of the new statutory scheme. The occupational schemes for blue-collar workers and employees in the municipal sector have already been transformed into (mainly) defined contribution schemes, where at least a part of the pension savings can be invested in private funds according to the pension saver’s choice. Negotiations concerning the pension scheme for non-manual staff in the private sector have been going on for several years. No agreement has been reached so far, but the trend is the same. There has been no significant changes in the scheme for state employees.

Since the collective occupational schemes cover the entire labour market, there are almost no special company schemes.

There are no corresponding collective systems for self-employed.

There has been a steep increase in private pension savings during the latest decades. Unit linked pension insurances have been available on the Swedish market since 1990. There will be no further treatment of purely private pension assurance in this report. It should be noted, though, that both the statutory and the occupational systems now contain strong elements of private insurance. Public and collective pension schemes are moving toward private insurance. Financing is still public, collective and mandatory, but the accrued pension rights are increasingly treated as private property and pensions calculated in accordance with actuarial principles.

2. ILO conventions

Sweden ratified ILO convention 102 on minimum standards on social security in 1952. The convention lays down minimum standards for the personal scope, the conditions of entitlement and the level of compensation in the national pension schemes. The convention is old and the minimum standards are rather low in comparison with the European pension systems of today. The Swedish system clearly fulfils the required minimum standards. It has a general coverage and the level of compensation is much higher than the one required in the convention.

Convention 128 prescribes higher standards for invalidity benefit, old age benefit and survivor's benefit. Sweden ratified this convention in 1968. The Swedish system complies with the prescribed standards for invalidity benefit and old age benefit, but not the prescribed standard for survivor’s benefit, since the convention requires that there is a pension for surviving wife. Widows’ pensions were abolished in Sweden 1990. This part of the convention can hardly be applied in a country where the rate of women in gainful occupation is almost equal to that of men.

III CLASSIFICATION AND DESCRIPTION OF THE PENSION SYSTEM

The Swedish pension system is a three-pillar system, where the main pillar is the Earnings-based pension, which ramifies into a PAYG branch and a prefunded branch. The central pillar is supplemented, on one side by the Guarantee pension, a minimum benefit for pensioners without an adequate earnings-based pension and, on the other side, of the occupational top up schemes.

I will treat the three components of the general Swedish pension system, the Earnings-based statutory pension, the Guarantee pension and the supplementary occupational schemes, in that order.

1. The Earnings-based statutory pension

The earnings-based system consists of two parts. The main part in a PAYG system, the other a premium fund system. Both parts have the same personal and material scope. The rules on contribution and how pension rights are earned are the same. They are also regulated in the same statute. Thus the two parts can be treated together. The special rules concerning the premium fund system will be treated after the rules that are common to both parts of the earnings-based scheme.

a. *A universal and mandatory scheme*

The earnings-based pension is universal and mandatory. It covers the entire population, even the self-employed and people with very low earnings. There are no possibilities to opt out of the system.

b. Material scope

The scheme covers only old age pensions, not early retirement on grounds of invalidity. There are special schemes for early retirement and early retirement on grounds of work injury. After pensionable age the benefits from these separate schemes are replaced by the old age pension. Widows’ pensions were abolished in 1990, but pensions to surviving children will be included in the old age pension scheme.

c. Financing

The system is financed by contributions from employers and employees and, if necessary, by other state revenue. Employers’ contributions are constructed as a payroll tax, which is levied even on parts of the pay above the upper earnings limit. Employees' contributions are calculated only on parts of the earnings below the upper earnings limit and are collected in the same way as taxes. The current rate is 6.95 percent for employers' contributions and 6.40 percent for employees' contributions. The self-employed pay contributions that correspond to both these parts. The contributions are in the first place collected by the state. The state is then obliged to transfer an amount equivalent to 18.5 percent of pensionable income and pensionable amounts to the two pension systems. 16 percentage points go to the PAYG system, the remaining 2.5 percentage points to the prefunded system. Thus there is no direct relation between contributions paid by employers and employees and the actual amount of money that is transferred to the pensions systems. A deficit must be filled by other state revenue. Pay-roll tax is levied even on pay that gives no right to pension. On the other hand the state transfers money also on pensionable income that has not been subjected to any pay-roll tax, for instance sickness benefit and unemployment benefit. State contributions to the pension systems are also paid on some fictive income, the so-called "pensionable amounts". The stable point in this contribution defined system is thus not the amount of contributions paid by employers and employees, but the fixed rate of contributions that the state must pay to the pensions system, which in turn is related to taxable earnings.

d. How pensions rights are "earned"

Pension rights are calculated on taxable income from work up to the upper earnings limit, which is linked to an index reflecting the trends in average earnings. Pension rights for self-employed, who are sole traders, are calculated on business income. Social security benefits are taxable and generate pension rights in the same way as income from work. The level of compensation in short term benefits like sickness benefit and unemployment benefit ranges between 80 and 90 percent. Even long periods of sickness or unemployment will not cause any substantial loss of pension rights for people with ordinary earnings.

Further, pension rights are also calculated on certain pensionable amounts, first and foremost the so-called child years. Pension rights for child years are very generous. One of the parents in a family, where there is one or more children under 4 years, is credited with a pensionable amount corresponding to the earnings she or he had the year before the child was born or to 75 percent of the average earnings of the working population, if this latter amount is higher. The rules are constructed in a formally gender-neutral way. The parents may decide for themselves who of them shall be credited with the childcare years. If they do not, the pensionable amount is awarded to the parent with the lower income, which in most cases is the woman. Swedish women often work only part time during the years with young children. In the previous pension system, the effect of the years with young children and part time work was neutralised by the rule of "the best 15 years". An important part of the background to the generous rules on child years is that it was not considered politically acceptable that pensions for a large group of women became lower in the new system than in the previous one.

Pension rights will also be calculated on study years with a statutory study grant and periods of compulsory national service (military or non-military). These rules on pension rights for study years are not yet finalized, but they will certainly not be as generous as the rules on child years.

The upper earnings limit for 1999 is 7.5 x 4.150 = 31.125 euro. About 10 percent of the population gainfully employed now have earnings above that qualifying limit. In the future the upper earnings limit will follow the average earnings index. The proportion of the population with earnings above the ceiling will thus remain about the same.

There is also a lower earnings limit, which coincides with the lower earnings limit for taxable income. It is defined as 24 percent of one base amount, for the time being about 1000 euro. Even people with discontinuous and fragmented work careers will earn pension rights in proportion to their earnings.

e. *Yearly revaluation of accrued pension rights.*

Accrued pension rights in the PAYG system are revalued each year according to the average earnings index. The value of the pension assets in the prefunded system follows automatically the value of the fund(s) in which the money has been invested. In both systems, accrued pension rights of those who have died are distributed among the pensioners in the same age cohort in proportion to their pension assets (survivor's bonus).

f. Pensionable age

The normal pension age in Sweden is 65 years for men and women alike. This is also the normal retirement age, when employment protection comes to an end and the employee is obliged to leave employment if the employer so wishes. In the new earnings-based pension scheme there is, however, no fixed pensionable age. The claimant can choose to take out pension from 61 years and he can postpone pension for an indefinite time. The time when pension is claimed influences the amount of pension according to actuarial principles. A person who goes on working after "normal" pensionable age continues to accumulate new pension rights. Since there is no longer a maximum qualifying period more earning years will always result in a higher pension.

The system is extremely flexible and offers a maximum degree of personal choice as to when and how the accrued pension rights can be claimed. The claimant may chose to take out a fraction of the accrued pension rights, i.e. 1/4, 2/4 or 3/4 of full pension benefit. He can also choose to claim pension only from one of the two branches of the scheme (the PAYG branch and the prefunded branch) and postpone payments from the other system. It is also possible to stop a pension already in payment, for instance if the claimant gets a new job. Even in the PAYG system the accrued pension rights are thus treated as a personal capital over which "the owner" can dispose freely so long as the capital is used for his own pension.

g. Calculation of pensions in payment.

The point of departure is the value of aggregated pension rights at the time when pension is claimed. In the PAYG system the value has been continuously adjusted to the earnings index. The value of the total pension assets in the PAYG system is divided with a coefficient determined by average life expectancy. The coefficient for a certain cohort is based on the most recent life expectancy over a five-year period. An increase in life expectancy will thus result in lower pensions. The divisor is the same for men and women though women have longer life expectancy.

In the prefunded system pensions shall be calculated in accordance with "recognised principles of insurance", i.e. in accordance with life expectancy. However, there is an explicit rule that pensions for men and women shall be built upon the average figure for both sexes together.

In principle the remaining pension assets shall continue to be adjusted to the average earnings index even after pension has begun to be paid out. Under the assumption of a certain economic growth – that would result in the pension being relatively low in the beginning of the pension period and increasing over time. For most people the transfer form gainful occupation to pension will mean a substantial loss of income. Therefore, the expected benefits from future growth are taken into account already from the beginning of the pension period. The calculation is based on an assumed rate of growth at 1.6 percent yearly. If that assumption holds, the pension will be the same in real prices during the entire pension period.

In the prefunded system the amount of pension paid each month will depend of the actual value of the fund(s), when the payment is due. This unit-linked, variable pension can, if the claimant so wishes, be recalculated to a traditional pension with fixed annuities.
In this case the premium pension authority overtakes the financial risk. Private insurance companies usually offer the same possibility to transform a unit-linked pension into a fixed annuity pension when the insured has reached pensionable age.

h. Fund management in the prefunded scheme

An amount equivalent to 2.5 percent of pensionable income is transferred by the state to the individual pension accounts in the prefunded scheme. A new authority, the Prefunded Pensions Administration, administers the individual pension accounts. The savings will be reinvested in security funds operated by independent fund managers. The individual pension saver decides in which funds the pension savings shall be deposited. There is however no direct legal relationship between the security fund manager and the individual pension saver. It is the Prefunded Pensions Administration which holds the units in the fund where the money is invested and pays out the pensions. It will be possible to change from one fund to another without any restrictions, but the savers must bear the administrative costs of such transfers themselves.

The pension savings in the prefunded system can be managed by security fund managers and international funds that are licensed to operate in Sweden. There will also be a state-owned fund operating on the same conditions as the private funds. Deposits can also be made in index funds.

Private companies which want to participate in the system must be registered with the Prefunded Pensions Administration and comply with certain conditions. They must conclude an agreement with the Administration on practical operation and a maximum price for their services. They must undertake not to take any charge for withdrawals when pension is claimed. They must also supply information both to the Administration and individual savers on how the fund is managed, especially expenses withdrawn from the fund.

The system with private fund management is not yet in operation. The money hitherto transferred to the prefunded system is temporary deposited in an account with the National Dept Office.

i. Allocation of pension rights between spouses and survivor's option

The prefunded system offers some possibilities for the pension saver to use his pension rights in the prefunded system in favour of a spouse (registered partner) or surviving children.

Women in general earn lower pensions than men do. Part of the explanation is that women take on a greater responsibility for children and homework. Married couples may wish to even out differences in pension rights accrued during marriage. A spouse (or a registered partner in a homosexual relationship) can transfer his right to premium pension to the other spouse (partner). The transfer refers to pension rights that will accrue in the future. After the local social security has been notified the transferred pension rights will be paid into the individual account of the other spouse. The transfer can be terminated at will but already transferred pension rights belong to the other spouse.

The costs for such transfers must be borne by those who choose this possibility. As a rule it will be men who transfer pension rights to their wives, who have a longer life expectancy. The cost for such a transfer will therefore be rather high. A figure of 14 percent of the transferred rights has been mentioned. A transfer of pension rights to the other spouse during a life-long marriage will have a rather substantial effect on the final pensions for the two spouses respectively. This part of the system is not yet in operation.

The mandatory system gives almost no protection to the surviving spouse. Widow's pensions were abolished in 1990 and replaced by a transitional benefit awarded only for the first year after decease. The prefunded system offers a possibility to obtain a better protection for survivors. Survivor's protection before the pension saver has reached pensionable age is constructed as a temporary survivor's pension that is awarded during a period of five years after the death of the insured. The insured person can choose between two insurance amounts, defined as one or two base amounts per year, which today correspond to about 350 or 700 euro per month. The pension can be allocated to spouse, registered partner and in some cases to another cohabiting partner or to the children according to the choice of the pension saver.

Survivor's protection after the pension saver has begun to draw pension consists in a recalculation of the pension so that it will be awarded as long as one of the spouses or partners is alive.

The cost for the voluntary survivor's protection is calculated according to actuarial principles and drawn from the pension saver's individual pension account. There are rules on waiting periods and several other rules to avoid adverse selection.

2. The Guarantee pension

The Guarantee pension replaces the former "folkpension". The new Guarantee pension is only awarded to those not entitled to an earnings-based pension that satisfies the guaranteed level, which is related to a price index, not the earnings index.

However, individuals who have worked, but not enough for their earnings-based pension to reach the guaranteed level, receive a supplementary Guarantee pension above the guaranteed level. This supplementary Guarantee pension, which may seem inconsistent with the general design of the system, is aimed for the rather large group of women who have only worked part time or not at all during periods of their (married) lives.

The amount of benefit is related to the household in such a way that individuals living together with a spouse or a partner receive a lower pension than individuals living alone. The guaranteed level for a single pensioner is about 9 000 euro and for a pensioner living together with a spouse or a partner a little lower.

The Guarantee pension is cleared against the Swedish earnings-based pension and similar pensions from other countries, but not against other income, not even occupational pensions or private pensions.

The Guarantee pension can not be claimed before "normal" pension age, i.e. 65 years. Claims before normal pensionable age would imply that the guaranteed pension became so low that it would not satisfy a reasonable basic minimum level. Furthermore, the rules reflect that the Guarantee pension is aimed to supplement the earnings-based pension and that the freedom of choice in the earnings-based scheme must not lead to a higher Guarantee pension. The Guarantee pension must always be claimed at the same time and in the same proportion as the earnings-based pension. A pensioner, who defers his earnings-based pension until 70, is not entitled to a guarantee pension between 65 and 70. The Guarantee pension for an individual, who has used some of his pension capital in the prefunded system to obtain a better survivor's protection, is calculated as if this transaction had not taken place.

Taken alone the Guarantee pension cannot be characterised as a means-tested or income-related benefit, since it is only cleared against other statutory pensions, not against other income. However, in most cases the guaranteed level is not enough to obtain a decent standard of living and the pension must be supplemented by a special housing benefit for pensioners. The housing benefit is income-related.

Pension rights are "earned" through residence in the country and awarded in proportion to the period of residence. The qualifying period for a full pension is 40 years. Special rules make it possible for refugees to obtain a full pension though they have only resided in the country for a shorter period. These rules will possibly be extended to cover also other groups of migrants.

3. Occupational pensions

Practically all employees are covered by one of the supplementary occupational pension schemes based upon central agreements between the labour market parties and financed exclusively by the employer. The occupational pensions are constructed as top up schemes in relation to the statutory pension. The assembled level of compensation has hitherto made up around 70-80 percent of final salary, often a little higher during the first five years after retirement. In the future there will be no such guaranteed level. Preserved rights are protected in all the schemes. Employees can normally go from one scheme to another without any substantial loss of pension rights.

a. The state employee scheme (central government sector)

This scheme covers about 550.000 employees. It is unfunded and pensions are financed by current state revenue. The scheme covers old age, invalidity and death. It is still a final salary scheme, though somewhat modified after the pension reform. Even fractions of the final salary above the upper earnings limit in the statutory scheme give right to pension. There is an upper earnings limit in the occupational scheme too, but so high that it is of almost no practical importance. Employees with salaries above that ceiling usually have special pension arrangements. The pension is also related and proportioned to the number of employment years. Full pension requires 30 years of employment after the age of 28. Only years with at least 40 percent of full employment count as qualifying years. Pension age for the great majority of state employees is 65 years. There are no possibilities to claim the pension before pensionable age (except in case of invalidity) or to postpone pension.

This scheme has been renegotiated in the early 1990s, but the changes are small, especially in comparison with the three other occupational schemes.

b. The municipal employee scheme (local government sector)

The scheme covers almost a million employees – Sweden has a big public sector. It gives protection for old age, invalidity and death. It is still basically an unfunded book reserve scheme, where pensions are paid out of current tax revenue.

The main part of the scheme, pension for earnings below the upper earnings limit in the statutory system, has been transformed into a defined contribution scheme. When pension is claimed accumulated pension rights are recalculated into an annuity pension. A small part of the contributions shall be paid into an individual pension account in a private pension insurance company or a security fund that the employee has chosen. The employer can decide that a greater part of the contributions shall be paid into the individual accounts. Thus the scheme can, if the employer so wishes and can afford it, be transformed gradually into a prefunded defined contribution scheme with individual pension accounts.

The part of the pension above the statutory ceiling is still a defined benefit scheme of a modified final salary type. Pension is calculated on the salary during the last seven years prior to pension. The required qualifying period for a full pension is still 30 years of service.

Normal pensionable age is 65 but pensionable age has become much more flexible in the new scheme. Pension can be claimed between 61 and 67 years of age and also in fractions of a full pension.

c. Schemes for non-manual workers in the private sector.

This scheme covers about 600 000 employees. There are some special schemes for certain sectors very similar to the main scheme. The following description refers to the main scheme. It is prefunded. Premiums are paid to a private insurance company or to a pension fund within the employer's company. In the latter case pension obligations are secured through a special guarantee. A lesser part of the contributions are paid into individual pension accounts of the employee's choice. There is a greater freedom of choice for employees with high salaries (more than 10 base amounts). The pension is a net pension based on final salary and covers about 10 -13 percent of the part of the final salary that is below the upper earnings limit in the statutory scheme and about 65 percent of the part of the final salary above that limit. There is an upper earnings limit in this scheme too, but it has little practical importance. Those with earnings above that ceiling would have special pension agreements that are even more favourable. A full pension requires 30 years of service after the age of 28 with at least 40 percent of full time.

Pensionable age is very flexible. Pension can be claimed from the age of 55 and postponed until the age of 70. The time when the pension is claimed will determine the amount of pension in accordance with actuarial principles.

There are in this prefunded system no guarantees that pension rights and pensions will be adjusted for inflation or increases in general earnings. However, in actual practice, accumulated surplus has regularly been used to grant pension increases.

This scheme has been under renegotiation since the early 1990s. The parties have already agreed that the part of the pension below the statutory ceiling shall be transformed to a defined contribution scheme, where the assets can be invested in individual pensions accounts in private funds. The crucial issue seems to be how the part of the pension above the statutory ceiling shall be construed. The employer side wants it to be a defined contribution scheme, while the employee side wants it to remain a final salary scheme.

d. The scheme for manual workers

The scheme covers about a million employees. Risks covered are old age and invalidity. There are no survivor's pensions.

This scheme has been completely renegotiated after the pension reform. The previous pension was a net pension corresponding to about 10 percent of the average earnings during the three "best years" between 55 and 59 up to the upper earnings limit in the statutory scheme. Contrary to the other schemes there were no pension rights for parts of the earnings above the ceiling. Very few blue-collar workers though have earnings above the ceiling. A full old age pension required like in the other schemes 30 years of service after the age of 28.

Now the scheme has been transformed into a prefunded defined contribution scheme with individual pension accounts. Contributions corresponding to the agreed percentage of earnings are paid into individual pension accounts in a life insurance company or a security fund. The current contribution rate is 2 percent of the earnings, but will be higher next year. A special life insurance company, AMF Pension, owned by the parties to the agreement, has hitherto administrated the pensions. There is a special agreement that premiums paid can be re-borrowed by the company. AMF Pension together with AMF Fund Insurance now offers both traditional pensions and unit-linked pensions in different equity funds. Since 1998 the employees have had the right to freely choose their insurer, but two thirds of them have remained with AMF Pension.

Pensionable age under this scheme is now very flexible. The invalidity pension gives a high level of compensation.

IV REFORM OF THE NATIONAL PENSION SYSTEM - TRENDS

1. Background to the reform

The previous additional pension scheme was introduced in 1960. During the 1950s and 1960s GDP increased by over 3.7 percent per year. After 1975 average annual growth has been less than 2 percent. The scheme was designed in such a way that it required an annual growth of at least 2 percent to pay the guaranteed benefits without increasing contributions. The demographic development in Sweden has followed the same trends as in the rest of Europe with longer life expectancy and lower birth rates. There has also been an increase in early retirement. In 1960 for each pensioner (including early retirement pensioners) there were 5.4 people in gainful employment. In the end of the 1980s this figure had decreased to the half, 2.7. The main reason, -1.4, was the demographic changes. The lowering of pensionable age accounts for -0.8 and the increase in early retirement for - 0.5. Prospective figures for the years to come – not taking early retirement into account – is 30 pensioners for every 100 people in working age in the year 2000 and 41 pensioners for every 100 people in working 25 years later. If early retirement is taken into account and the dependency ratio, defined as the number of people in gainful occupation in relation to the number of pensioners including the early retired, the figures get worse. The forecasted figures for the years 2005, 2010, 2020 and 2025 are 2.27, 1.92, 1.84 and 1.78 respectively (SOU 1990:76 p. 181). Previously the increasing number of pensioners was balanced by an increasing number of women entering the labour market. No corresponding increase can be expected for the future. The rate of women in gainful employment is now almost the same as for men.

The previous system was in no immediate danger. Contributions have been lower than pension payments ever since 1983, but the deficit has been covered by the yield on the buffer fund. The scheme was deliberately over-funded in order to create a buffer. Contributions were fixed at a higher rate than necessary to meet current pension payments. At the end of 1997 the assets in the buffer fund amounted to 80 billion EURO, which represents a very high funding level in a PAYG system. The direct yield of the assets amounted to 5 billion euro, of which 4 were used to finance pension payments.

However, taking into considerations recent economic and demographic trends the system could not be upheld in the long run without increasing contribution rates to levels that would impede economic growth. It is also a question about “fairness between the generations”. Such an increase in contributions would be unfair to the younger generation.

This is the double explanation to the most important trend in the Swedish pension system, namely the shift from a defined benefit scheme to a defined contribution scheme.

2. Basic Trends and Principles

a. From defined benefits to defined contributions

The most important trend is the shift from the defined benefit approach to the defined contribution approach, which creates a link between the pensions and the living standards of the pensioners and the earnings and the living standards of the generation in gainful occupation that pays for the pensions. This linkage has a double meaning or purpose. Seen from an economic point of view, the pensions become better adapted to available resources. From a normative point of view it represents a fair agreement between the generations. Good times and bad times will affect everybody in the same way.

b. From final salary to lifetime average earnings

The new scheme built on life-time average earnings represents a normative shift from a system that shall preserve the position established in the end of a normal working life career to a system which emphasises work as the only economic and moral ground for a pension. It is also better adapted to more flexible work patterns.

c. A pension in proportion to previous earnings

The upper earnings limit in the previous scheme was only adjusted to a price index. In the long run this would have implied a gradual transformation of the earnings-related pension into a basic pension at the same amount to all persons with a normal working career. In 1960 only 3.1 percent of the men had earned maximal pension points. 1988 this figure had risen to 8.1 percent. With a continued increase in real earnings of 2 percent per year 75 percent of all men and 50 percent of all women would have hit the ceiling by 2025. With the automatic adjustment of the ceiling for increases in real earnings, the statutory system will remain a system that awards earnings-related pensions to the great majority of the population.

d. Greater flexibility and more room for individual choice

Several features in the new scheme contribute to make it even more flexible than the previous one. All work counts the same irrespective of how the working career is composed. The individual can choose his own pensionable age within a wide spectrum. In the prefunded system the individual can decide how her pension assets shall be invested and also use the accrued pensions rights in a rather free manner. However, there is no flexibility and no individual choice in the rules on how pension rights are financed and earned.

An interesting feature in the new pension system is that the proportion between the PAYG system and the prefunded system can be changed very easily since pension rights are financed and earned in the same way in both parts of the scheme. The only rule that must be changed is the one deciding how much of the total contributions shall be paid into the two systems respectively.

A precondition for the high degree of flexibility and free choice in the new system is that benefits are calculated in accordance with actuarial principles. The individual can to a great extent decide how his earned pension rights shall be used, but he must pay for his choices in accordance with actuarial principles. It should, however, be noted that there is no actuarial connection between contributions paid by employers and employees and the pension rights earned in the system.

e. Solidarity remains

The Guarantee pension represents a strong element of solidarity in the new system. It gives the same or an even better basic protection than the old folkpension.

The redistributive elements are as strong in the new system as in the previous one. The Guarantee pension is based on solidarity. The redistributive elements in the earnings-based system are to be found in how the system is financed and how pension rights are earned, and apply in the same way to both parts of the earnings-based system. Employers' contributions are levied even on fractions of salaries above the upper earnings limit. Pension rights accrue, not only from "real earnings" from work, but also from social security earnings, child years, study years and years of national service.

Thus the new pension system demonstrates that it is possible to combine within the same system rather strong mandatory redistributive elements and elements fetched from private insurance that allow for flexibility and individual choice.

f. A pragmatic solution for women with a mixed housewife/working career

Generous pension rights for childcare years as well as supplementary Guarantee pension above the guaranteed level to groups with a typical mixed housewife/working career are elements that are in fact alien, both to the Swedish social security system in general and to the new earnings-based pension system. The Swedish system does not encourage part time work or women (or men) staying at home after the period of parental benefit has expired. These elements in the new system shall, according to my view, be interpreted as pragmatic measures to avoid lower pensions for large groups of Swedish women in the new system, not as a shift to a more housewife-oriented social security system.

3. How consensus was achieved

The main features of new pension scheme were elaborated by a group consisting of representatives of the parties in Parliament and adopted by Parliament in spring 1994, but many questions were still left open. The work continued within a special committee consisting of representatives from the five parties that had agreed on the main features, which worked in collaboration of the Ministry of Health and social affairs. In spring 1998 the Bills on the new pension system were presented and adopted by Parliament.

The crucial point was evidently that five of the seven parties in Parliament succeeded in reaching an agreement. Nobody outside the inner circle knows how the necessary political compromises were reached. There has been astonishingly little public discussion on the new pension system. The participating party representatives have obviously avoided making their different opinions a public political issue. There have been two elections since the work on the new pension system began. The pension reform has not been an issue in the electoral campaigns. The public discussion has mainly concerned how the contributions shall be shared between employers and employees.

A consensus has thus been reached between political parties representing a great majority in Parliament. The citizens seem to have accepted the new scheme as a necessary and unavoidable reform.

A few matters remain to be finalised. The most important are the following.

The earnings index used to decide adjustments of pension rights and the level of pensions in payment reflect average earnings, not total earnings. This may under certain conditions result in financial instability. There is already an agreement between the parties on a “automatic financial stabilizer”, but the details are not yet available. The stabilizer is generally called “the brake”, but it shall be constructed in such a way that it can also function as an “accelerator” in case economic growth should rise faster than expected.

Early retirement pension, which was a part of the previous old age pension scheme, is not included in the new pension system. The new disability pension will rather be constructed according to the “sickness benefit model”, but a detailed proposal does not yet exist.

Employees are, as a rule, obliged to leave employment when they reach the retirement age agreed upon in the collective agreement governing the conditions of employment. Normal retirement age in the collective agreements is 65 years. The new pension scheme presupposes that more persons shall choose to work longer and thus both contribute to the financing of the new scheme and earn a better pension for themselves. But this in turn often presupposes that there is a right to stay in employment after reaching 65 years of age. This is considered to be an issue for the parties in the labour market t solve, but the said parties have not yet been able to reach an agreement. Recently a proposal was made by the Government that employees shall have the right to stay in employment until reaching 67 years even if the agreed retirement age in the collective agreement is 65 years. The proposed legislation will enter into force by the year 2001 if the parties of the labour market have not by then reached an agreement on retirement age that is better adapted to the new pension scheme.

How contributions shall be shared out between employers and employees is another issue not yet solved, but it does not affect the main structure of the system, which is based on the contributions the state has to pay into the pension system. For the time being the surplus from the buffer fund in the previous system can be used to supplement the contributions from employers and employees, which do not yet amount to the presupposed 18.5 percent.

After these and some other minor questions have been solved the pension reform is completed. There are no plans for further reforms.

4. Trends in occupational pension schemes

The development in the occupational pension schemes is marked by the same trends as the development in the statutory system. There is a movement from defined benefit schemes to defined contribution schemes, from final salary pensions to pensions based on average earnings, from PAYG-schemes to prefunded schemes and from schemes with a guaranteed interest to unit-linked schemes. Pensionable age is becoming more flexible and there is more room for individual choice. It can be expected that this development will continue. All the occupational schemes have so far not been adapted to the profound changes in the statutory scheme.

5. Gradual introduction of the new pension scheme

There are no recognised principles for protection of accrued rights in public pension (or other social security) schemes against later amendments that could result in smaller benefits than under the previous rules. When the widow’s pension was abolished in 1990 the Government stated that there could not be any vested rights in a PAYG-type scheme. In the preparatory work to the new pension scheme the Government has stated that the accrued rights in the prefunded part of the scheme are protected by the constitutional rule on property rights. No corresponding statement has been made for the PAYG-part of the scheme.

In practice, however, changes in the social security system are introduced gradually with transitory rules protecting those who have been insured under the previous scheme.

The transfer from the old to the new pension system is arranged in the following way. Those born before 1938 will not be affected by the new scheme. “The middle generation” persons born 1938-1953, will be phased-in gradually in the new scheme. A lesser or greater part of their pensions, depending on which year they were born, will be calculated according to the old scheme, the other part according to the new. People who have “earned” most of their pension rights under the old scheme will have their pensions calculated according to the new rules. This may in some cases lead to lower pensions, especially for those who were favoured by the maximum qualifying period of 30 years and the rule of “the best 15 years” in the old scheme. Women who stayed at home for some years with their young children will, however, get pension rights even for child years that were completed under the old system. There is a guarantee clause that people belonging to “the middle generation” shall always be entitled to a pension calculated in accordance with the old rules on income earned up to 1994 - the year when the guidelines for and basic principles of the new system were adopted by Parliament - in case this amount is higher than the amount that would be awarded under the new rules.

To conclude, it is fair to say that a reasonable attention has been given to accrued rights and legitimate expectations under the old scheme. The transitory rules would presumably stand a test in the German Constitutional Court.