



Sweden: Swedish Pension Reform

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SWEDEN

SWEDISH PENSION REFORM

Executive Summary

In 1999 a new pension system was introduced in Sweden. Prior to 1999, Swedish retirement was secured through earnings-related benefits in addition to universal coverage. After the reform individual investment accounts were created for retirement benefits, in addition to income related benefits and a guaranteed pension.

I. The System Prior to Reform¹

The first pension reform in Sweden took place in 1913, when a new pension law was introduced. It is sometimes called the origin of Sweden's universal social protection even though it did not offer universal coverage. It was a "means-based" system and as a result excluded some people from receiving coverage. A universal pension system was not established in Sweden until after World War II, through the establishment of a People's Pension in 1946. The system extended equal benefits to all people having reached the pension age. It turned out to be difficult to find political agreement on the formation of the public pension system but in the 1960's the ATP (in Swedish, Allmän tillägspension) plan was implemented. The plan was an "earning related benefits" plan which offered benefits in addition to the universal benefits. Buffer funds were established (AP-funds) to compensate for a decline in private savings and make up for possible future demographic and economic upsets. The ATP plan was a pay as you go and defined benefits plan. Full pension benefits were reached after thirty years employment on the fifteen best years of earnings. The target level was sixty percent of past earnings and pensions were fixed to a consumer price index which formed the so-called base-amount.²

The People's Pension was a success and the success of the plan meant that poverty and inequality for the elderly population in Sweden were almost erased.³

Despite the success of the system, it faced serious problems. The system was under-financed and the AP-funds were at risk of depletion. The alternatives available were to lower benefits or to increase contributions, but to increase contributions to match benefits would have been too heavy a burden for the working population.⁴

II. The New System

In the beginning to mid 1990s a new pension system was debated in Sweden. In June of 1994, the Swedish Parliament adopted new guidelines for the pension system and in April of

¹For a review of the old and present pension systems in Sweden please see an article by Joakim Palme, director of the Institute for Future Studies in Stockholm: *The "Great" Swedish Pension Reform*, available at Sweden.se The Official Gateway to Sweden <www.sweden.se> (last visited Mar. 14, 2005)

² *Id.* at 1

³ *Id.*

⁴ *Id.* at 2.

1998 a Government Bill, based on the adopted guidelines, was introduced to the Parliament, proposing an overall reform of the public pension system.⁵ The purpose of the pension reform was to create a system that would follow the economic and demographic developments in Sweden.⁶

In 1999, the new pension system was introduced. A novelty is that pension entitlements are based on a person's whole working life. The system has three components: (i) a defined contributions system, pay-as-you go-system (DC PAYG), (ii) a funded premium pension system (individual accounts), and (iii) a guaranteed pension financed with general revenues from the government's budget.

(i) The DC PAYG System

The DC PAYG system is financed through contributions from both the employer and the employee in a total of sixteen percent of earnings. Contributions are recorded in personal accounts and are used to pay current pensions. The accounts thus represent claims on future pensions. The self-financed system is autonomous from the central government's budget, but the government does contribute to cover unemployment, parental leave and sick leave.

Retirement age is flexible and benefits can be collected from the age of sixty-one.⁷ The annual benefits are calculated by dividing the individual's account by the number of life-expectancy years.

(ii) The Funded Premium Pension System – Individual Accounts

The premium pension is a fully funded individual account. It is compulsory and 2.5 percent of contributions (out of the 18.5 percent total) are invested in funds by the individual. There are over 600 funds to choose from (both Swedish and foreign) and the individual can choose a fixed or variable annuity upon retirement. If the worker does not choose a fund, the 2.5 percent is placed in a specific publicly managed fund, and not among the 600 other choices (in Swedish called *Premiesparfonden*).

(iii) The Guaranteed Pension

The guaranteed pension ensures that those with low or no income receive benefits upon retirement. The benefits are graduated, making it possible to receive a small guaranteed pension while receiving most of one's pension from the earnings-related systems. The guaranteed pension, together with a means-related housing allowance, is higher than the minimum income standard in Sweden.⁸

Furthermore, 90 percent of Swedish employees have supplementary funded pensions based on collective bargaining agreements, with contributions of about two to five percent of

⁵ Proposition [Prop.] 1997/98:151 Inkomstgrundad ålderspension m.m. [Government Bill] (Swed.).

⁶ *Id.* at 1.

⁷ The maximum retirement age is 67. Kleen Anna, Nordstrom Tomas, Ministry of Finance, Holmgren Nils, Palmer Edward, National Social Insurance Board, *Country fiche for Sweden*, Nov, 2, 2001, p. 3.

⁸ *Id.* at 4.

earnings. This accounts for seventeen percent of total pension spending. Last, four percent of the total pension spending is done through voluntary pension funds or insurance companies.⁹

III. The Results

The Swedish pension reform was seen as radical and has been perceived as a model for other European countries.¹⁰ Still, the system is under debate in Sweden and even though in many ways the reform has been a success, there are also problems.

One of the main problems seems to be either a lack of public information or that information is not reaching the larger population.¹¹ As mentioned above, there are over 600 funds to choose from when choosing a pension fund, which can cause confusion. Only forty-two percent of workers know what a premium pension is; seventy-five percent cannot tell how their money is administered; and only sixty-seven percent make an active choice of a particular fund. When a fund is closed, thirty percent of savers make an active choice to replace their savings in another fund; seventy percent do not make a choice and their savings are thereby transferred to the publicly managed fund (*Premiesparfonden*).¹² This fact suggests that information about the system needs to be improved. Recently, the Swedish Prime Minister admitted that he believes that information given to the public about the new pension system has not been clear enough and that some may be upset when they realize the effects of the pension reform. Many politicians do not agree with his assessment and believe that the information has been extensive.¹³

One cannot choose to place one's savings in *Premiesparfonden*, and once savings are removed from the *Premiesparfonden*, they cannot be returned. This has sparked criticism¹⁴ and can certainly be seen as frustrating, because *Premiesparfonden* has been doing very well. As a result those who have not made an active choice in placing their pension-savings have had better results with less risk than those who have made an active choice.¹⁵ Some have suggested simplifying the system, for example, by punishing or removing bad funds, funds that do not reach the index or funds with too few members. There is, for example, a fund that only has one member. There is disagreement on whether reducing the number of funds would be a good alternative; while it could make choosing a fund less confusing¹⁶, it would also decrease the variety of fund offerings.¹⁷ One suggestion is to create a rating system for the funds and have the Premium Pension Authority administer the rating system.¹⁸

One of the goals of the new system was to provide those with no or low income with security upon retirement. Under the new system those who receive the guaranteed pension and survivors

⁹ Natali, David, *Sweden The Reformed Pension System, Research Project La Methode Ouverture de Coordination (MOC) en Matiere des Pensions et de l'Integration Europeenne*, supported by the Service Public Federal Securite Sociale, Observatoire Social Eurpeen, 2004.

¹⁰ *Id.*

¹¹ Every year pension savers receive account statements with information about their pension savings by regular mail.

¹² Socialförsäkringsutskottets betänkande 2003/04:SfU5 Det reformerade pensionssystemet [Committee Report] p 6.

¹³ Winiarski, Michael, *Persson varnar för sämre pension*, DAGENS NYHETER, Feb. 18, 2005.

¹⁴ *Id.* at 5, 7.

¹⁵ *Id.* at 6.

¹⁶ Cowell, Alan, *Sweden's take on Private Pensions*, NEW YORK TIMES, Feb. 12, 2005.

¹⁷ Socialförsäkringsutskottets betänkande 2003/04:SfU5 Det reformerade pensionssystemet [Committee Report] p 6.

¹⁸ *Id.*

pension or housing allowances have a higher net income than they would have under the old ATP-system, which is a success for the reformed system.¹⁹

The Vice President for the Seventh AP-fund, Peter Norman, has stated that it is a benefit that every individual can choose the level of risk at which to administer his own savings; and that it is easy and fast to change funds and thereby also change one's risk-profile. The system allows the individual to speculate, and if the speculation generates profits the individual keeps the profit but if he loses, the state compensates for some of the losses through the guaranteed pension.²⁰

Still, despite the system's success, some feel that the system entails too much risk and that the public does not possess enough knowledge to properly administer their pension-savings. Many Swedes valued the security of knowing exactly how much they were going receive in pension payments every month and find the new system confusing, partly because of the large numbers of funds from which to choose, and partly because of the risky nature of saving in the stock market.²¹

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¹⁹ *Id* at 7.

²⁰ *Id.* at 6-7.

²¹ Cowell, Alan, *Sweden's take on Private Pensions*, NEW YORK TIMES, Feb. 12, 2005.