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**Research Report**

## Politics and organized interests in Swedish pension policy

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# STUDY

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# POLITICS AND ORGANIZED INTERESTS IN SWEDISH PENSION POLICY

Karen M. Anderson

## ABSTRACT

Sweden is often hailed as a model for far-reaching pension reform. The comprehensive 1994/1998 reform replaced the existing statutory system that had been in place since 1960 with a new system based on notional defined contributions, individual investment accounts, and a guarantee pension. The reformed pension system also includes “automatic stabilizers” that ensure that pension liabilities and assets remain in balance. Sector-wide occupational pension schemes provide a topup to public pensions. This study analyses the origins, negotiation, and effects of the reformed pension system. It discusses the weaknesses of the preexisting system and the broad political compromise that emerged in the 1990s around reform and continues to shape the direction of policy change. The study also examines the role of occupational pensions in the overall pension system, the role of unions in shaping the reform, and the links between labour market performance and the pension system.

# Content

<b>1</b>	<b>Introduction</b>	<b>3</b>
<b>2</b>	<b>The 1994/98 Reform</b>	<b>5</b>
2.1	Why Reform? The ATP Pension and its Weaknesses	5
2.2	The Road to Reform	10
<b>3</b>	<b>The Structure of the Reformed Pension System</b>	<b>12</b>
3.1	The Guarantee Pension	13
3.2	Income-related Statutory Pensions	14
3.3	Financing	17
3.4	Automatic Stabilizers	17
3.5	Occupational Pensions	19
3.6	The Size of the Overall Pension System	20
3.7	Social and Economic Consequences of Reform	21
3.8	Distributional Aspects of the Reform	24
<b>4</b>	<b>The Current Politics of Pensions</b>	<b>27</b>
<b>5</b>	<b>Evaluation</b>	<b>31</b>
<b>6</b>	<b>The Pension System and the Labour Market</b>	<b>33</b>
6.1	Recent Labour Market Performance	33
6.2	Labour Market Challenges to the Pension System	34
6.3	Is Sweden Best Practice?	35
6.4	Pension and labour market policies	35
<b>7</b>	<b>Conclusions</b>	<b>36</b>
	<b>References</b>	<b>37</b>

# 1 Introduction

Sweden is often hailed as a model for far-reaching pension reform. The 1959 ATP reform transformed separate schemes for white collar workers into a single earnings-related pension system for all wage-earners, eradicating gaps in coverage for manual workers. The ATP pension, coupled with the universal, flat-rate basic pension, provided generous retirement income and incorporated all wage-earners and the self-employed into a single, unified system.<sup>1</sup> By the 1980s, however, the ATP system began to show weaknesses, particularly increasing pension expenditures and a decreased capacity to provide adequate income replacement for growing numbers of middle class employees. These weaknesses placed pension reform on the political agenda and ushered in two decades of debate about how to reform the system. A "big bang" reform was adopted in the 1990s under non-socialist and social democratic governments based on very wide, cross-party agreement in the Swedish parliament (*Riksdag*). The five (later six) parties behind the reform also formed a Pension Group to negotiate future adjustments to the system. The Pension Group continues to negotiate the parameters of pension policy change today.

The Swedish pension system is based on both statutory and collectively organized occupational pension provision. The 1994/1998 reform replaced the existing statutory system (the ATP earnings-related pension and the basic pension) that had been in place since 1960 with a new system based on defined contributions. Today, the reformed statutory pension system consists of an income pension (*inkomstpension*) based on the principle of notional defined contributions (NDC), mandatory individual defined contribution (DC) investment accounts (the premium pension; *premiepension*), and a minimum pension (the guarantee pension; *garantipension*) for those with insufficient statutory pension rights to lift them out of poverty. The 1994/98 reform also changed the administrative structure of statutory pensions: the income pension and premium pension schemes are administered by state agencies, and they are not part of the government budget. In contrast, basic provision (guarantee pension and income-tested supplements) are part of the government budget. The very high degree of collective bargaining coverage means that four sector-wide negotiated occupational pension schemes (*avtalspensioner*) cover about 88 % of the workforce and provide a top-up of about 10 % for average earners. Individual private pension savings do not play an important role in retirement provision. The reformed pension system also includes automatic stabilizers that ensure that (notional) pension liabilities and notional and funded assets remain in balance. These automatic stabilizers ensure that the system remains resistant to demographic and economic developments.

In contrast to most statutory schemes in the EU, the Swedish system relies on a mix of pay-as-you-go (PAYGO) financing and capital funding. The AP Funds (*Allmänna pensionsfonderna*) established when the ATP system was introduced continue as buffer funds in the new system, with assets totaling about 29 % of the gross domestic product (GDP) (at the end of 2018). The AP Funds were set up as buffer funds in the early 1960s. ATP contributions were set higher than actuarially necessary in order to build up financial reserves that could be invested in the domestic economy, particu-

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<sup>1</sup> ATP: Allmän Tilläggspension; General supplementary pension, see below section 2.1

larly in the housing sector. Since 2001, the four AP Funds invest in a range of financial assets, with different assets mixes across the four funds. The new premium pension system includes assets equal to about 32 % of GDP (at the end of 2020; Pensionsmyndigheten, 2021a). Collectively negotiated occupational pension schemes rely more on capital-funding than the statutory system, with assets equal to about SEK 2,924 billion, or 60 % of GDP (at the end of 2018; Pensionsmyndigheten, 2020).

The goals of the reformed pension system are to provide adequate old-age pensions and encourage labour market participation. As discussed below, the old ATP system introduced in 1960 provided invalidity and survivor's benefits, but these have either been radically reformed (survivor's benefits) or transferred to other branches of the social insurance system (invalidity). In addition, the reformed system does not permit early retirement. There is a minimum retirement age for the guarantee pension (65 years), but there is no standard retirement age for the income pension; retirement is possible starting at age 62.<sup>2</sup> The defined contribution structure of the income pension and premium pension is intended to tighten the link between wage-based contributions and pension benefits, whereas the goal of the guarantee pension and means-tested benefits is to provide basic provision (*grundskydd*) for persons with incomplete employment profiles.

This report analyses the origins, negotiation, and effects of the reformed pension system. The report discusses the weaknesses of the existing system and the political compromise that emerged in the 1990s around reform. The report also examines the role of occupational pensions in the overall pensions, the role of unions in shaping the reform, and the links between labour market performance and the pension system.

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<sup>2</sup> Legislation adopted in 2019 raised the minimum pension age from 61 to 62. Those born 1958 and earlier may still retire at 61.

## 2 The 1994/98 Reform

The 1994/98 reform aimed to establish and maintain political and financial sustainability. This means that the broadest possible political consensus should underpin the reformed pension system, and that the design of the pension system should ensure long-term financial sustainability.

The reformed pension system is *politically sustainable* because it rests on a compromise that includes nearly all parties currently represented in the Riksdag. The initial compromise included the Social Democratic Party (*Sveriges socialdemokratiska arbetareparti*, SAP), the Center Party (*Centerpartiet*), the Liberal Party (*Liberalerna*), the Christian Democratic Party (*Kristdemokraterna*), and the Conservative Party (*Moderaterna*). These five parties represented 80 % of the seats in the Riksdag in 1994 and 1998. After the reform was implemented in the late 1990s/early 2000s, the five parties formed a Pension Group (*Pensionsgruppen*) to monitor the effects of the reform and negotiate necessary amendments. All five parties agreed that any changes to the reformed pension system would require the consent of all members of the Pension Group (Anderson and Immergut, 2007). The Green Party (*Miljöpartiet de Gröna*) joined the Pension Group in 2014. Only the right-wing populist Sweden Democrats (*Sverigedemokrater*) and the Left Party (*Vänsterpartiet*) remain outside the Pension Group.

The search for political consensus concerning the pension system is rooted in failed reform attempts in the 1980s and shifts in electoral politics. The pension system, especially the old earnings-related ATP, is widely considered to be the crowning achievement of Social Democratic reform politics. This success was, however, the result of protracted, intense and bitter political conflict in the 1950s that culminated in the 1959 legislation that established the ATP system. Voters went to the polls four times in four years to vote on pension issues (three parliamentary elections in 1956, 1958 and 1960 and one referendum, in 1957), and the final legislation passed by a razor-thin margin. The legacy of this long and conflictual process was a widespread understanding in the 1990s that political conflict on pensions was to be avoided at all cost, and this view was shared by both the center-left and the center-right (Anderson, 2018; Lundberg, 2003).

### 2.1 Why Reform? The ATP Pension and its Weaknesses

The reformed pension system replaces the ATP system introduced in 1960. ATP broke with previous pension policy by setting up a statutory earnings-related pension scheme based on the best 15 of 30 years of labour market participation. The new ATP did not replace the existing basic pension (*folkpension*) and means-tested supplements; instead, ATP pensions would insure earnings above the fairly low level of the basic pension. The background to the ATP reform was the uneven coverage of earnings-related pensions. In the early post-war period, public employees and white-collar workers enjoyed generous occupational pensions while the majority of workers, mainly in industry, only had access to the flat-rate basic pension. Metalworkers, later supported by the Trade Union Confederation (*Landsorganisation*, LO) were the first blue collar group to demand earnings-related pensions on equal terms with white collar workers (Molin, 1965; Hecló, 1974).

When the ATP system was introduced in 1960, employers paid 3 per cent of payroll into the system, but this contribution rate increased quickly, reaching 10 per cent in 1970 and 13 per cent in the 1990s (starting in 1982, there was no income ceiling on contributions). Employer contributions also financed a large share of the costs of the basic pension: 5.66 per cent of payroll to finance the basic pension (the contribution was 3.3 per cent of payroll in 1974 and peaked at 9.45 per cent in 1989 before it was phased out in 1999 as part of the 1994/98 pension reform). It is important to note that employer contributions invisible to the wage-earner (they were not reported on payslips) largely financed social insurance expenditure until the late 1990s. This included the sickness insurance system, unemployment insurance, parental insurance, and work injury insurance. By the 1990s, the volume of employer contributions was heavily criticized by employers and their political allies, as well as many economists, for driving up wage costs (see, for example, Svenska Arbetsgivareföreningen, 1990). I return to this point below.

Box 1 sets out the benefit rules for the ATP pension. Wage earners accrued pension rights based on the best 15 of 30 years of labour market participation up to a ceiling that was intended to be roughly equal to 70-80 % of average wages. This formula was intended to benefit women and white-collar workers who tend to work fewer years and experience more rapid wage growth in their later years of employment. The 15-30 rule was the primary concession made to white collar groups in order to gain the support of TCO (the union confederation for salaried employees) for the ATP reform in 1959 (Anderson, 2001).

**BOX 1:**  
**Calculation of ATP and Basic Pension for worker with 40 years of average wages, retiring in 1992**

**Base Amount in 1992** = SEK 33,700

**Average Annual Wage in 1992** = SEK 176,400 (figures available on scb.se).

Average Annual Wage in 1992 = 70 % of ATP earnings ceiling, or about 5.3 base amounts

40 YEARS of employment; highest earnings years at average insurable earnings (5.3 points per year average)

$[30/30 \times 5.3 \times \text{SEK } 33,700] = \text{SEK } 178,610$

$60 \% \times \text{SEK } 178,610 = \text{SEK } 107,166$

The ATP pension amount is about 60 % of average wages (SEK 176,400).

When 96 % of the basic pension is added for a **single pensioner**, the total amount (SEK 32,352 + SEK 107,166) is equal to SEK 139,518, or about 79 % of the insured person's 15 "best" years (i. e. average salary every year).

A **married pensioner** would receive 78.5 % of one base amount for the basic pension ( $0.785 \times 33,700 = \text{SEK } 26,454$ ), bringing the total pension to SEK 107,166 + SEK 26,454 = SEK 133,620, or about 75 % of average wages.

When the ATP system was set up in 1960, Swedish policy-makers devised an accounting device called the "base amount" (*basbelopp*) as the basis for determining the level of the basic pension and the calculation of ATP pension points.<sup>3</sup> The value of the base amount was adjusted to inflation annually. The organizing principle of the ATP system was that it would insure income above the level of the basic pension. Starting in 1968, the value of the basic pension for a single person had been set to 90 % of one base amount and 140 % of the base amount for couples (i. e. 70 % of one base amount each; the level for singles was later increased to 96 % of one base amount). The ATP system insured income between one and 7.5 base amounts. This meant that the maximum number of ATP points a wage earner could accrue per year was 6.5 (one point was equal to one base amount). At retirement, a wage earner would automatically receive an amount equal to 96 % of one base amount from the basic pension. The ATP pension was calculated by multiplying the proportion of required years (at least 30 for a full pension) by average career pension points and the current value of one base amount. This number was then multiplied by 60 % (see box 1). Figure 1 below shows the combined structure of the pension system from 1960-2003.

It is important to emphasize that the earnings ceiling was indexed to inflation (via the base amount), rather than wages. This would prove to be a major weakness in the long-term (see below), but it was considered reasonable and effective at the time. Contributions to the ATP system were initially set higher than pension costs, and the surplus capital accumulated in the state-run AP Funds. The ATP pension and the existing basic pension (*folkpension*) together paid about 65 per cent of average wages for the typical wage earner. According to the generous transition rules, the system would approach maturity by the early 1990s. The AP Funds also grew quickly; by 1992, these funds stood at SEK 512 billion, or 35 per cent of GDP. In addition, four sector-wide occupational pension schemes added about 10 percentage points to the replacement rate for average earners, and insured earnings above the ceiling for above average earners.

The ATP system also included provisions for disability pensions (*förtidspensioner*) and family pensions (*familj pensioner*). Disability pensions became available for wage-earners whose ability to work was reduced because of a physical disability before they reached retirement age. Family pensions provided both a widow's pension (*änkepension*) payable until retirement age and a child pension (*barnpension*) available until the child reached legal age. The ATP system was also modified several times since its establishment to make it compatible with women's increasing labour market participation. In the 1970s social insurance benefits like unemployment and parental insurance were made pension-carrying. No contributions were paid for these pension rights, however. In 1976, the partial pension (*delpension*) (financed by a small employer contribution) was introduced, and in 1982 parents could begin counting years caring for children younger than age three as equivalent to labour market participation for ATP benefits. Starting in 1990 lifelong survivor's pensions started to be slowly phased out (SOU, 1994a: p. 21).

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<sup>3</sup> 1957 was the first year that the base amount was used, and it was set to SEK 4,000. See Elmér, 1971, p. 199.



The ATP reform marked a turning point in Swedish politics and social democratic strategy because it represented a shift from tax-financed flat-rate social insurance like the basic pension, to earnings-related benefits financed by employer contributions. However, the introduction of the ATP system did not obviate the need for flat-rate pensions and means-tested supplements. Pensioners with insufficient pension rights based on employment could draw the flat-rate basic pension, which municipalities could add to with means-tested supplements (*pensionstillägg*) adjusted to local living costs and housing allowances (*kommunala bostadstillägg*) (Elmér, 1971).

Figure 1: The Swedish Pension System from 1960-2003

<b>collectively negotiated pensions</b>	private sector salaried occ pension	private sector manual occ pension	state employees occ pension	local gov't employees occ pension	self-employed and workers not covered by collective agreement
	<b>ATP</b> <ul style="list-style-type: none"> <li>• earnings-related old-age pension</li> <li>• survivor's pension</li> <li>• disability pension</li> </ul>				
<b>Statutory pensions</b>	<b>basic pension</b> <ul style="list-style-type: none"> <li>• basic pension</li> <li>• pension supplement</li> <li>• municipal housing supplement</li> <li>• wife's supplement</li> <li>• special municipal housing supplement</li> <li>• support for the disabled</li> <li>• special pension supplement</li> </ul>				

Source: Elmér, 1971; 1989.



By the 1980s, economists and actuaries pointed to growing weaknesses in the ATP system, particularly the growing costs of benefits relative to contribution revenues and the increasing number of wage-earners with earnings above the ATP ceiling (by 1992 the ceiling was about 70 % of average wages, and it was indexed to inflation, not wages; hence the base amount and the nominal value of pensions were also indexed to inflation; see box 1 above). The ATP's reliance on inflation-based indexation was also identified as a grave weakness. The ATP system had not been designed for a context of low economic growth, increasing life expectancy, and long periods of rising real wages, which meant that there was a growing gap between wages and pensions (Lindbeck, 1992; Bröms, 1990). The structure of financing for the basic pension and the ATP system also attracted strong criticism. Since 1982, ATP contributions had not been sufficient to finance expenditures, and the gap has increased in the 1990s because of the 1991-1995 economic crisis. Moreover, experts at the National Insurance Board predicted politically unsustainable increases in future contributions and the

rapid depletion of the AP funds (Riksförsäkringsverket, 1987). Revenue shortfalls in the basic pension system also exacerbated central budget deficits as the state picked higher proportions of the financing for this system.

Critics of the pension system also focused on the allocation of pension contributions between employers and employees. When employer contributions were first introduced, this was seen as a victory for the labor movement. In the 1990s, however, this aspect of pension financing was attacked by those who argued that the invisibility of pension contributions to the wage earner fueled demands for higher wages and improved pension benefits. Making pension contributions visible to wage earners was a major issue in the pension reform process even though this would not change the actual amount of contributions paid (see, for example, Svenska Arbetsgivareföreningen, 1990).

The expansion of pension-carrying income also contributed to the ATP's financing problems. Sick pay, unemployment insurance, parental insurance, and the years spent caring for children were made eligible for pension points in the 1970s and early 1980s, but these were "unfinanced" in the sense that no contributions were paid for these pension rights. In addition, the SAP government eliminated the contribution ceiling in 1982 (no pension rights were earned for income above the ceiling, however). These policy adjustments along with the structure of the ceiling, the indexing formula (best 15 years of 30), and the effects of economic growth during the first three decades of ATP's existence significantly altered the link between contributions and benefits. In the 1980s, earnings rose faster than benefits because of the effects of economic growth, so the tax proportion of ATP (the share of contributions not earning pension rights) increased as the system matured (Ståhlberg, 1993, p. 85). As more and more incomes exceeded the contribution ceiling, ATP began to function more like a bigger basic pension than as an earnings-related pension system. According to Ståhlberg's (1993, p. 87) calculations from the early 1990s, by 2025 with an annual economic growth rate of 2 %, 75 % of men and 50 % of women would have had incomes over the ceiling for which they would receive no benefits.

Finally, ATP's generous benefit formula made it particularly sensitive to demographic change and labour market transformation, especially reductions in working time. Reductions in working time meant wage-earners contributed less to the system, weakening the revenue base. Moreover, ATP's generous 15/30 benefit formula meant that many reductions in working time did not translate into reduced pension rights, resulting in a permanent deficit in the ATP system.

In sum, the ATP reform was tremendously successful in that it extended statutory earnings-related pension provision to all wage earners and the self-employed. Public support for the pension system was very high, and the Social Democratic Party and the union confederations could claim the reform as their own achievement. However, ATP's design generated unintended negative effects, particularly the co-existence of permanent deficits (covered by AP Fund income) and the declining capacity of the system to insure all of the earnings of well-paid manual workers. These unintended effects were the backdrop to a protracted political struggle to reform the system.

## 2.2 The Road to Reform

As the ATP system began to reach maturity in the early 1980s, its weaknesses were fairly well-known. Most experts agreed that key aspects of the system would be difficult to sustain as the large cohorts born in the 1940s began to retire. However, demographic change did not dominate reform debates (as in Germany) because relatively high fertility rates (1.74 in 1985) coupled with high women's labour market participation meant that future dependency ratios were not considered to be unsustainable. Moreover, income from the AP Funds could compensate for shortfalls in contributions. Instead, ATP's financial construction and its effect on labour supply were the main sources of concern.

Despite the wide popularity of the pension system, employers and their political allies heavily criticized the level of basic pension and ATP contributions, arguing that high non-wage labour costs seriously threatened the competitiveness of the export sector. In addition, employers criticized the role of the pension system in decreasing national savings and the accumulation of publicly controlled capital in the AP Funds. The Social Democratic government at the time was clearly on the defensive given the emerging consensus about the ATP's weaknesses, but it nevertheless set up an official commission of inquiry in 1984 to analyse the structure and performance of the pension system and propose necessary reforms. The Pension Commission (*Pensionsberedningen*) included representatives from the main political parties, as well as experts from the union and employers' federations, pensioners groups, and relevant ministries (see SOU, 1990).

The Pension Commission worked for five years, largely agreeing on the main weaknesses of the system, particularly ATP's declining capacity to provide earnings replacement, especially for average earners. Because of the relationship between the ATP system and the basic pension and means-tested benefits available to low-income pensioners, a person with a basic pension and no ATP points received a pension roughly equal to the ATP pension of an industrial worker. Moreover, the unintended weakening of ATP's earnings-replacement function meant that middle and higher income workers would have to rely on occupational and private pensions.

Despite agreement concerning the need for reform, the Pension Commission could not agree on a specific reform blueprint. Instead, the Commission's report identified several possible reform options: tightening the link between contributions and benefits, perhaps by increasing the number of minimum qualifying years and the reference period for the benefit formula (i. e. best 20 of 40 years); and indexing pension accrual and pay-outs to economic growth rather than inflation. When the report was circulated for comment many of the groups responding considered the proposed changes to be inadequate and voiced their desire for substantial reform. Nearly all of the organizations commenting on the report voiced their support for a more actuarial ATP system. Only the pensioners groups opposed any change in benefit indexing (SOU, 1990).

The Social Democratic Party and unions were particularly concerned about the long-term financial sustainability of the pension system. If the ATP system could not provide adequate old age provision for the working and middle classes, it would lose legitimacy. Again, the source of concern was largely the impact of ATP on labour supply and its capacity to insure the earnings of workers earning average and slightly above average wages, rather than demographic change. The Trade Union Confederation (LO)

largely supported the Pension Commission's recommendations, especially raising the income ceiling and making pensions more responsive to economic growth. The Federation of White Collar Unions (TCO), however, opposed any departure from the 15/30 rule for benefit calculation (SOU, 1990).

The shifting electoral landscape broke the political stalemate concerning pension reform. The SAP was kicked out of office after a close election in 1991, but the leadership agreed to cooperate with the four governing parties on a comprehensive pension reform. The government and SAP formed a parliamentary group headed by the Liberal Minister of Social Affairs in 1991; the SAP got two members, and other parties got one member each. This would be the beginning of the Pension Group that continues to negotiate the parameters of the pension system.

The five-party group agreed on the principles for the reformed pension system in June 1994. Supplementary pensions would remain obligatory and universal, but the benefit formula changed significantly: a defined contribution lifetime earnings formula would replace the ATP's 15/30 defined benefits formula. Average earners would continue to receive a pension equal to about 65 % of final salary. Payroll contribution levels remained stable at 18.5 % of pensionable income, but would now be shared by employers and employees. Employees were not compensated for the introduction of individual pension contributions because employers and unions have wage-setting autonomy. However, employees received some compensation via the tax system (the individual contribution paid from gross wages) and via collective bargaining. An important novelty was the introduction of mandatory individual investment accounts (the premium pension): 2.5 percentage points of contributions would flow into individual accounts that allow pension savers to choose their own investments from a range of approved options (16 percentage points went to the income pension). A state agency would administer the individual investment accounts. 1998 legislation adopted under an SAP minority government provided the detailed rules for the premium reserve and the transition to the new system (Anderson, 2001; Anderson and Immergut, 2007). A new guarantee pension would replace the old basic pension, and unlike the income pension, it would be indexed to inflation (SOU, 1994a).

The changes in policy design were intended to create financially sustainable pensions. However, political sustainability was also a central concern. All participants agreed that avoidance of political conflict was essential and were committed to finding common ground that would allow all parties to claim some sort of victory: the SAP could claim that the reform stabilized the ATP system to make it fit for the future, and the four non-socialist parties could claim important gains (see Anderson and Immergut, 2007 for details). All four non-socialist parties wanted to reduce the size and influence of the AP Funds, introduce some sort of individual premium reserve, replace the 15/30 rule with a lifetime earnings benefit formula and switch from DB to DC. The SAP had to compromise on the premium pension and the reduced role of the AP Funds. Framework legislation on the principles of the new pension system was adopted in June 1994. 1998 legislation implemented the main elements of the reform, and the new system was operational in 2001.

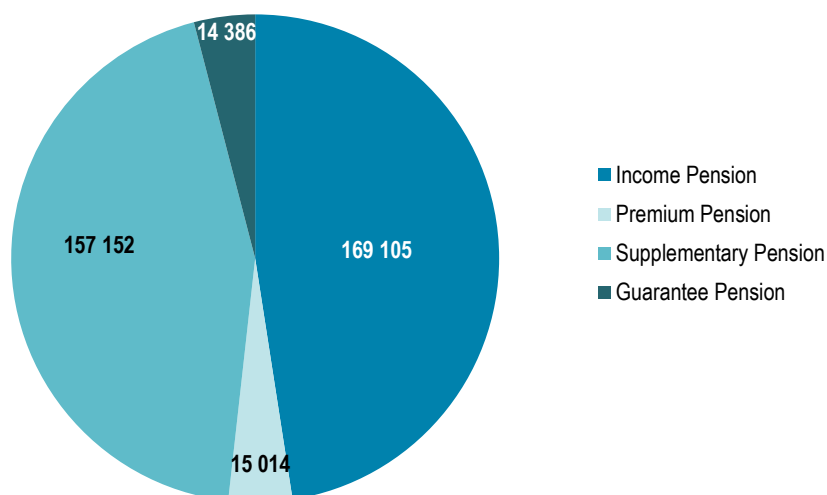
### 3 The Structure of the Reformed Pension System

The reformed pension system applies to persons born 1954 and later. Those born 1938-1953 are subject to transitional rules, and those born before 1938 still fall under the old ATP system. The first pension payments from the new system were made in January 2001. As figure 2 below shows, half of pension payments went to pensioners who fell (at least partly) under the old ATP rules in 2019. Like the old ATP system, all persons with income from work (employees, civil servants, self-employed) participate in the statutory pension system. This means that all groups on the labor market are treated equally in the pension system.

Swedish policymakers typically describe the pension system as a pyramid-shaped structure (see figure 3 below). The broad, bottom section consists of statutory provision: the guarantee pension provides basic security for those with insufficient income-related pension rights; the income pension provides NDC pensions based on lifetime earnings; and the premium pension provides an annuity based on income from individual investment accounts. In addition, four sector-wide occupational pension schemes cover 90 % of employees. Private pensions are relatively unimportant.

Before discussing the details of the new system, it is necessary to explain some central concepts. As noted, pension contributions and benefits are calculated according to an accounting device known as the "base amount" (*basbelopp*) which was introduced in 1960 as part of the ATP reform. The reformed pension system is based on two variants: the "price base amount (PBA)" (*prisbasbelopp*) is indexed to prices and the „income-related base amount (IBA) (*inkomstbasbelopp*) is indexed to wages. The price base amount applies to the guarantee pension, and the income-related base amount applies to the income pension. In 2020, one price base amount equals SEK 47,300, and one income base amount is equal to SEK 66,800. In 2019, the average wage (SEK 35,300 per month) was about 82 % of the income ceiling (SEK 43,309 per month).

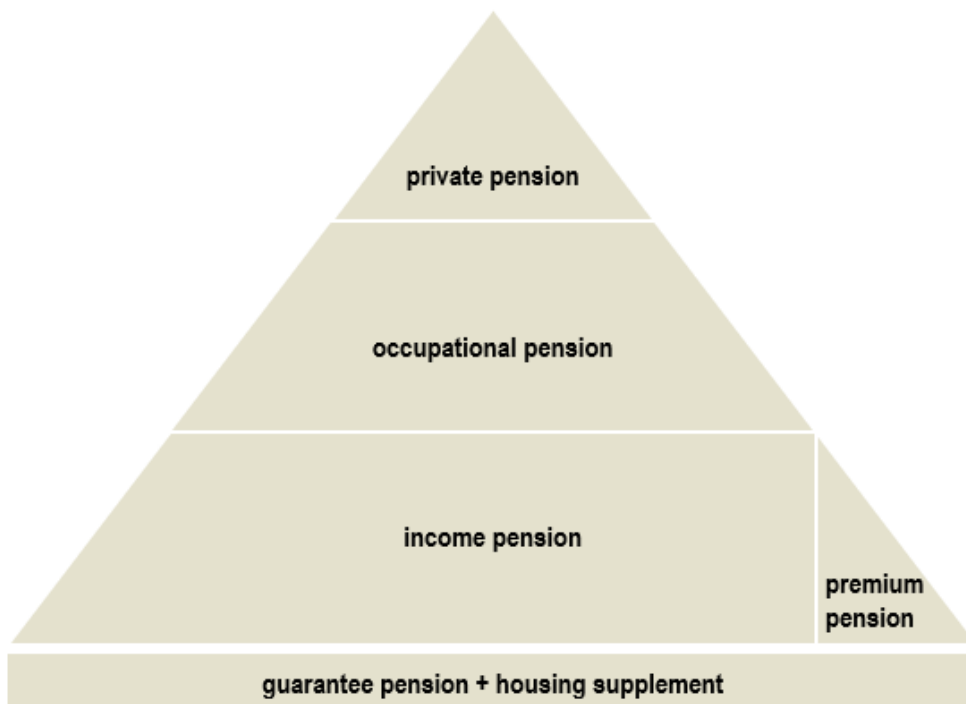
Figure 2: Pension Payments in 2020, SEK millions



Source: Pensionsmyndigheten, 2021b, p. 25

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Figure 3: The Structure of the Swedish Pension System



Source: adapted from Pensionsmyndigheten, 2021a

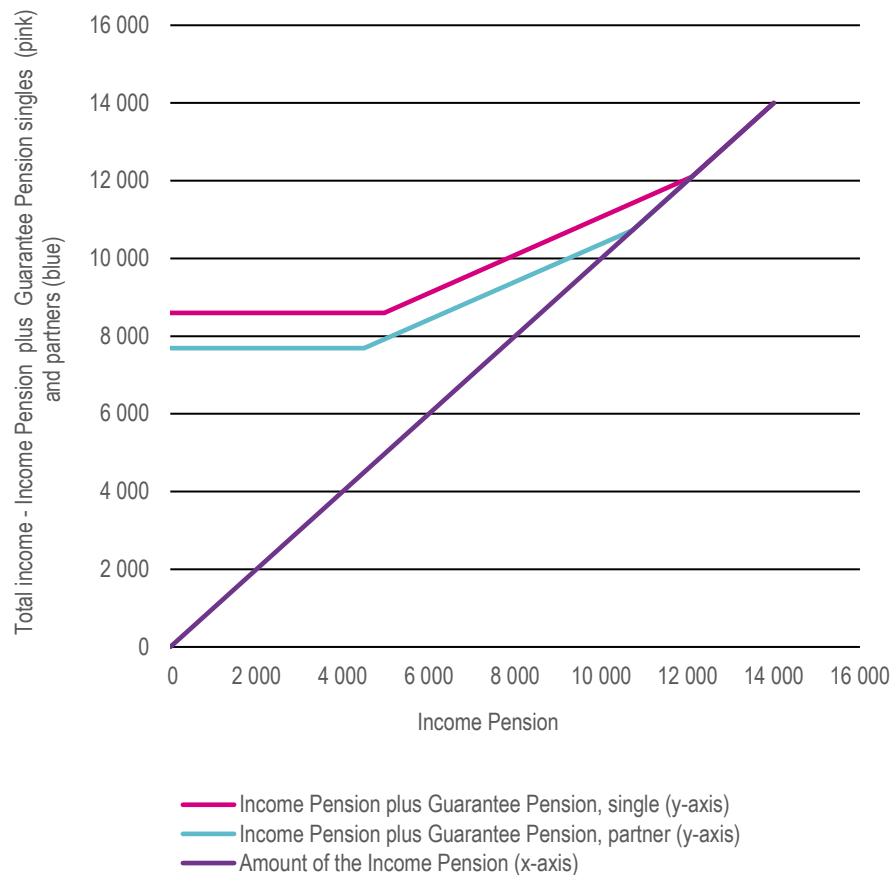
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### 3.1 The Guarantee Pension

The guarantee pension is part of basic provision for those with low or no income-related pension income. It is payable from age 65 to those with at least three years of residence. 40 years residence of residence in Sweden or another EU/EEA country<sup>4</sup> between age 16 and 64 are required for a full pension. The guarantee pension is reduced by 1/40 for each missing year. In 2021 the maximum amount is SEK 8,651 per month for a single person and SEK 7,739 for partners. As figure 4 (2020 data) shows, the guarantee pension supplemented low income pensions up to a threshold of SEK 8,395 per month (singles) and SEK 7,489 (partners). Thereafter, the guarantee pension tops up the income pension gradually until the combined benefit SEK 10,681 for partners/SEK 12,100 for singles was reached. Thereafter, no guarantee pension is paid. This means that a single pensioner with an income pension of SEK 12,530 or more per month in 2021 did not receive a guarantee pension. The guarantee pension is tax-financed and indexed to prices via the PBA.

<sup>4</sup> A recent case at the European Court of Justice establishes the principle that EU/EEA residence also qualifies as residence for the guarantee pension.

Figure 4: Income Pension and Guarantee Pension 2020, SEK per month



Source: Pensionsmyndigheten, 2021a, p. 32

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### 3.2 Income-related Statutory Pensions

All persons with income from work (employees, the self-employed, free professions) and social insurance (sickness, unemployment, parental insurance) participate in the income pension and premium pension schemes. Years spent in compulsory military service and child-rearing also earn pension rights.

The **income pension** is a "notional defined contribution" (NDC) pension based on lifetime earnings. Financing is largely pay-as-you-go (there are buffer funds; see parts 3.3 and 3.4), but individuals have notional accounts at the Pension Agency (*Pensionsmyndigheten*) where contributions are recorded (in Swedish crowns) in individual accounts as notional assets. This means that there are no "pension points" as in the old ATP system. Instead, individual earners' account balances (in Swedish crowns) are adjusted upward (or downward) annually according to an income index (*inkomstindex*) based on wage developments. Individuals do not own the notional assets in the income pension system (or the capital in the premium pension; see below). When an individual dies, his/her notional assets are

distributed to the other members of that cohort (these are known as *arvsvinster*, or inheritance gains).

The income pension at retirement is calculated by dividing the notional pension assets (in Swedish crowns after annual adjustments based on the income index) in an individual's account by an annuity divisor (*delningstal*) that is specific to each birth cohort (to take changes in gender-neutral life expectancy into account) and includes an advance rate of return of 1.6 % (*förskottsränta*). The advance rate of return increases the initial annual pension so that it is higher than it otherwise would be based on remaining life expectancy. When the individual's pension is adjusted annually, the advance rate of return is gradually deducted via the economic adjustment index (*följsamhetsindexering*) which is the income index minus 1.6 (the advance rate of return). The economic adjustment index thus adjusts notional pension assets and pension pay-outs to wage growth. The NDC benefit formula means that later retirement increases the pension benefit significantly because the annuity divisor decreases and pension assets increase. The reverse is true for earlier retirement. Administrative costs are deducted annually. The current minimum retirement age is 61, and the latest retirement age is 67 (these are very likely to change; see below).

The **premium pension** is intended to increase risk diversification and freedom of choice in the statutory system. 2.5 percentage points of the total 18.5 % pension contribution is credited to individual accounts at the Pensions Agency. Unlike the NDC accounts, premium pensions are capital-funded. Participants may choose up to five investment funds from a catalog listing more than 800 funds administered by 94 companies. To minimize administrative costs, pension contributions and fund choices are centrally managed by the Swedish Pensions Agency (from 2000-2011 the Premium Pension Agency, or *Premiepensionsmyndighet*, PPM, administered the system). Contributions are administered temporarily until individuals' tax liability is determined, and the amount of their premium pension credit can be calculated. When the exact amount of the pension contribution is determined, the capital is used to purchase shares in one to five investment funds that the person has chosen. The capital of non-choosers is invested in the seventh national pension fund, AP 7 Såfa (*Statens årskullsförvaltningsalternativ*), a life-cycle fund. All fund balances are annuitized at the time of retirement and can be paid out either as a fixed annuity (*traditional försäkring*) or as a variable annuity (*fondförsäkring*). For both, the capital is divided by the premium pension annuity divisor to calculate the annual pension. The divisor is adjusted for changes in future life expectancy for each separate cohort. If an individual chooses a fixed annuity, an individual's capital is sold to buy the annuity. If an individual chooses a variable annuity, the capital is not sold, but stays in the funds chosen by the individual, and the level of the premium pension is calculated every year depending on the value of the capital at the end of the year. In order to finance monthly pension payments, capital is sold each month. The premium pension includes the choice of a survivor benefit, a novelty in the Swedish pension system and a concession to the Christian Democratic Party (KDS) when the reform was negotiated. If a pension saver chooses the survivor's option, the monthly pension is lower. Premium pension savers may transfer



accumulated premium pension benefits to their spouse or registered partner. 98 % of such transfers are from men to women.<sup>5</sup>

The premium pension will not be fully mature until the 2060s. By then it is forecast to provide about 20 % of pension income (Regeringen, 2018). Table 1 shows the indexes for the market performance of the income pension and the premium pension for the period 2003-2018. In 2017, the index for the premium pension was 12.6 and this fell to -3.4 in 2018, reflecting the impact of the financial crisis. For active choosers, the average rate of return was 11.3 %, compared to 14.4 % for the default fund, AP S fa. The AP S fa fund has substantially outperformed the average return of private funds in the premium pension catalog since its establishment in 2010 (see latest figures at [www.ap7.se](http://www.ap7.se)).

**Table 1: Indexes in the Income Pension System and the Premium Pension System, 2003-2018**

	2003	2004	2005	2006	2007	2008	2009	2010
income/ balance index	3.4	2.4	2.7	3.2	4.5	6.2	-1.4*	-2.7*
premium pension index	17.8	8.8	30.6	12.1	5.7	-34.2	34.7	12.2
	2011	2012	2013	2014	2015	2016	2017	2018
income/ balance index	5.2*	5.8*	-1.1*	2.5*	5.9*	4.3*	2.6*	3.1
premium pension index	-10.7	12.1	21.1	20.7	6.4	10.9	12.6	-3.4

\* means that the balance ratio was below 1.0, activating the automatic balancing mechanism starting the following year. When the balancing mechanism is in effect, pensions are adjusted by the balance index until balance is restored.

Source: Pensionsmyndigheten, 2020

**WSI**

The premium pension has generated a higher average annual rate of return than the income pension from 2000 to the end of 2018 (table 1); during this period, the average annual rate of return for the premium pension was 7.1 % and 3.0 % for the income pension. At the end of 2018, premium pension capital was SEK 1,146 billion, or about 24 % of GDP. It is important to note that individuals do not own the capital in their premium pension accounts; instead, they have the right to a stream of income generated from the investments in their individual premium pension account. When a premium pension beneficiary or saver dies, their remaining capital is distributed to the surviving members of their birth cohort.

<sup>5</sup> Pension transfers are only allowed during the marriage or registered partnership. Partial transfers are not allowed, and the recipient receives 94 % of the value of the transferred pension value. The remaining 6 % is administered to the rest of the premium pension savers to compensate them for lost inheritance gains. The rationale here is based on the fact that 98 % are from men to women. Since men's life expectancy is lower than women's, this means that pension savers miss out on potential inheritance gains from men who transfer their premium pension savings to their female partners or wives.

### 3.3 Financing

Both the income pension and the premium pension are defined contribution (DC) schemes. This means that benefit accrual and income from individual investment accounts are the flexible elements in the system whereas contributions are fixed. There is also no state subsidy to the income pension and premium pension systems. As discussed, however, income from the state-run AP Funds may supplement contributions in the income pension system. The total pension contribution is 18.5 % of pensionable income: 16 % for the income pension and 2.5 % for the premium pension. Contributions are shared between wage-earners and employers: wage-earners pay 7 % of their eligible earnings up to a ceiling of 8.07 income based amounts (average wages are about 80 % of the income ceiling). Employers pay 10.21 % on income below the earnings ceiling, and half of this for earnings above the ceiling. The latter is called a “tax” rather than a pension contribution, and the revenues from it are transferred to the state budget rather than to the pension system. Because of the effects of the tax system, nominal contributions add up to 17.21 %, rather than 18.5 %. The net contribution, however, is 18.5 %, but this means that only contributions paid on 93 % of the income below the ceiling are credited to individual notional accounts. The central government pays the pension contribution for those receiving social insurance or unemployment insurance benefits that qualify for pension accrual. About 20 % of men currently have incomes above the ceiling, and 10 % of women (calculated from Pensionsmyndigheten, 2019 and [www.scb.se](http://www.scb.se)).

Contributions to the income pension are paid into the buffer funds, AP Funds 1- 4. As discussed above, the 2.5 percentage points for the premium pension are held in interest-bearing securities until the end of the year and then converted into the investments the individual has chosen.

### 3.4 Automatic Stabilizers

The reformed pension system also includes automatic stabilizers to ensure financial sustainability. In keeping with NDC principles, the ratio of assets to liabilities is calculated annually, and pension accrual and pay-outs take this balance ratio (*balanstal*) into account. The balance ratio is the ratio of current assets (notional and actual) to current liabilities. Assets are the notional value of recorded contributions and the actual capital in the buffer funds (in Swedish crowns), and this number is divided by the notional value of pension liabilities (in Swedish crowns). Liabilities are the current value of estimated pension payments to pensioners<sup>6</sup> and the accumulated notional value of individual income pension accounts.<sup>7</sup> If the ratio falls below 1.0, a balance index (*balansindex*) is used to adjust pension accrual and payments (instead of the income index) until balance is restored. This process

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<sup>6</sup> Pension liabilities are calculated by adding the sum of all workers' notional pension capital and the sum of pensioners' projected annual pension payments adjusted to remaining life expectancy.

<sup>7</sup> Wage earners have individual notional pension accounts. An individual's pension account is credited annually with the value of their pensionable earnings, and the accumulated notional capital in the account earns a notional rate of return. If the balance index is greater than one, the rate of return is equal to the income index. If the balancing mechanism has been activated, then notional pension capital is adjusted by the balance index.

is called "automatic balancing." The balance index is based on both the balance ratio and the income index.

As explained above, pension payments are adjusted annually to the economic adjustment index (income index minus 1.6), and the notional pension assets of the economically active are indexed to the income index. The automatic balancing mechanism operates with a one year delay: if the balance ratio falls below 1.0, this has no impact on pension accrual or pay-outs until one year later. The balance ratio fell below 1.0 for the first time at the end of 2008, affecting pension pay-outs in 2010. When automatic balancing applies, the balance index replaces both indexes, so the rate of return for pension assets and liabilities (the balance index) is lower than the income index, because the balance ratio is less than one. The system was in a balancing phase from 2010 to 2018, so pension accrual and pay-outs were not as high as they would have been by using the income index, and there were nominal cuts in 2010, 2011 and 2014. Pensions were reduced by 3 % in 2010 ( $-1.4 - 1.6 = -3.0$ ) by 4.3 % in 2011 ( $-2.7 - 1.6 = -4.3$  %) and by 2.7 % in 2014 ( $-1.1 - 1.6 = -2.7$  %). (Pensionsmyndigheten, various years). Pensioners were partially compensated via the tax system.

### **Box 2: Automatic Balancing**

balance ratio = ratio of notional and financial assets to liabilities in the income pension system

If the balance ratio is greater than 1.0, pension accrual is indexed to the income index, which is based on wage growth. Pension pay-outs are adjusted by the economic adjustment index, i. e. the income index minus 1.6 (the advance rate of return).

If the balance ratio is less than 1.0, the automatic balancing procedure is activated. This means that pension accrual and pay-outs are adjusted by the balance index until the balance ratio is higher than 1.0. The balance index is the income index multiplied by the balance ratio.

Table 1 (above) shows the development of different indexes over time. The Pensions Agency calculates these indexes yearly and uses them to adjust pension accrual and pay-outs. There is one exception: the premium pension index is simply an indicator and does not affect actual pensions. Individuals receive premium pensions based on their investment choices. It is noteworthy that the default fund, AP S fa, outperformed the average premium pension index by 75 percentage points (for assets invested since December 2000).

As the table shows, the premium pension index fluctuates more than the other indexes because capital is invested on financial markets. Changes in the income/balance index reflect wage growth and the ratio of notional and financial liabilities to assets. The balance number fell below 1.0 for the first time in 2010. Pensions were reduced in three years (2010, 2011 and 2014) during the balance period. The income index shows healthy growth since the end of the financial crisis. Economic adjustment indexing has been used since 2002. Even if reductions are included, the index has produced higher pension levels than price indexing would have (Regeringen, 2018a).

### 3.5 Occupational Pensions

Occupational pensions have a long history; by the 1950s, all white collar workers were covered, as were most public sector workers. Blue collar workers organized in LO-affiliated unions were the last to gain coverage, in 1973. Four collective schemes cover about 88 % of Swedish wage-earners (Kjellberg 2019, p. 41)<sup>8</sup>, adding an average of 10 % to income insured by the statutory scheme (Lindquist and Wadensjö, 2011; Anderson, 2015). About 90 % of those entering retirement have some form of occupational pension (*tjänstepension*). This is due to the very wide coverage of collective agreements. Most occupational pension schemes are capital-funded, defined contribution with individual investment choice. Occupational pensions are closely coordinated with the statutory pension system. However, higher income earners benefit disproportionately because most or all of their income above the statutory pension ceiling is covered. The wage-earners most likely to fall outside of these schemes include those working for small firms in the private service sector, especially IT.

In general, employers contribute 4.5 % of income below the statutory ceiling, and about 30 % on income above it. This means that occupational pension schemes supplement statutory benefits below the ceiling and cover all of the income above the ceiling. In 2017, 20 % of men and 10 % of women had employment income above the statutory ceiling. These design features mean that occupational schemes provide higher benefits for high earners compared to other groups (see Anderson, 2015 for details).

Employers and unions negotiate the details of occupational pensions in four sector-wide collective agreements:

- SAF-LO (blue-collar private sector workers);
- ITP (white collar workers in the private sector);
- PA03 (for state employees); and
- KAP-KL/AKAP-KL (for municipal employees).

Occupational pension schemes are largely funded DC schemes; most private sector schemes have individual investment choice. Private-sector schemes are DC, and participants choose between traditional and unit-linked annuities.<sup>9</sup> Public sector schemes combine elements of DC and DB (Lindquist and Wadensjö, 2011). The majority of private-sector negotiated pension schemes operate much like the premium pension. Participants bear all risk for their investment choices, and they choose from a range of pension products offered through non-profit fund clearinghouses owned by employers and unions. Public sector schemes follow a similar model. There is significant choice built into the schemes: participants can choose their financial service provider, survivor's benefits, and the length of the pay-out period (with a minimum of five years).

Occupational pension schemes are designed to balance the goals of individual choice and security. Participants have extensive choice within organizational structures designed to enhance security. Non-profit organisations owned by employers and unions administer private sector schemes, limiting

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<sup>8</sup> 100 % of public sector workers and 83-85 % of private sector workers are covered.

<sup>9</sup> Unit-linked annuities generate income based on the performance of the investments that the underlying capital is invested in.

the number and type of financial institutions allowed to offer pension products to occupational scheme members. This structure also allows pension schemes to keep management fees low and to exclude risky investment vehicles (Anderson, 2015; 2019).

### 3.6 The Size of the Overall Pension System

Occupational pensions are the most important source of retirement income after the statutory pension schemes, and their importance is increasing. The table below shows occupational pension contributions, assets under management, and payments in 2018. Annual contributions to statutory pensions (the income and premium pension; guarantee pensions are tax-financed), occupational pensions and private pensions are estimated to be SEK 519 billion in 2018. Statutory pension contributions account for 62 % of contributions (SEK 323 billion) and 43 % of assets (SEK 2,563 billion). The statutory pension provides 67 % of all pension payments in 2018 at SEK 314 billion. Although occupational pension contributions (37 % of all pension contributions) are significantly lower than those going to the statutory system, occupational pension assets are higher (49 % of all assets) than the statutory system (income and premium pension). The statutory system continues to dominate pension payments, but this will change as occupational pensions mature (Pensionsmyndigheten, 2020).

Table 2: Contributions, Assets and Payments for the Overall Pension System in 2018 (SEK billions)<sup>10</sup>

	contributions	% GDP	capital	% GDP	payments	% GDP
statutory pension	323 (62 %)	6.7	2,563 (43 %)	53.0	314 (67 %)	6.5
occupational pensions	194 (37 %)	4.0	2,924 (49 %)	60.5	127 (27 %)	2.6
private pension insurance	2 (0 %)	0.04	476 (8 %)	9.8	26 (6 %)	0.53
<b>TOTAL</b>	<b>519</b> <b>(100 %)</b>	<b>10.7</b>	<b>5,963</b> <b>(100 %)</b>	<b>123.5</b>	<b>452</b> <b>(100 %)</b>	<b>9.67</b>

Note: columns do not always add up to 100 % because of rounding.

Source: Pensionsmyndigheten, 2020

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<sup>10</sup> GDP was SEK 4,828 billion in 2018.

### 3.7 Social and Economic Consequences of Reform

The central goal of the reformed pension system is to provide adequate retirement income within a system that is responsive to economic and demographic fluctuations. In concrete terms, this has meant:

1. introducing automatic stabilizers so that statutory pensions remain financially sustainable;
2. strengthening incentives for individuals to work longer;
3. stabilizing non-wage labor costs;
4. spreading the risk of longevity across the pay-as-you-go pension and the capital-funded premium pension; and
5. giving individuals more choice in terms of when they retire and how their contributions are invested.

#### Political sustainability

As discussed in previous sections, the reformed pension system largely achieves the goal of political sustainability. The Pension Group established immediately after the legislation setting up the new pension system was adopted remains in place. This is a remarkable achievement, given that six national elections have taken place since 1998. All of the major parties have committed to negotiate changes to the pension system within the group, and they have resisted defecting from the group for electoral gain. All legislative changes to the structure of the pension system since 1998 have originated in negotiations within the Pensions Group. This includes changes to the automatic balancing mechanism in 2017, plans to increase the effective retirement age for the income pension and the minimum retirement age for guarantee pensions, and plans to improve basic provision for those with low income pensions. An important exception concerns tax policy (discussed below).

#### Financial sustainability

The reformed pension system largely meets the standard of financial sustainability understood as stable contribution rates. The NDC system requires annual calculations of the system's assets and liabilities, and the automatic balancing mechanism forces policy-makers to reduce pension accrual and pay-outs until financial balance is restored. As noted, the automatic balancing mechanism is an integral element of the pension system and does not require political decisions. The mechanism was activated for the first time in 2010, and the balancing period lasted until the end of 2017. As discussed earlier, automatic balancing may result in pension increases lower than the economic adjustment index, or it may result in nominal pension decreases. In 2010, pensions were reduced by 3 % in 2011, by 4.3 % in 2012 and by 2.7 % in 2014. In 2013, 2014, 2015, and 2016, pension benefits increased more slowly than the economic adjustment index (Pensionsmyndigheten, 2011; 2012; 2013; 2014; 2015).

The background to these cuts was the weak development of wages combined with large losses for the AP Funds in the second half of 2008, which drove the balance ratio below 1.0 for the first time. At the end of 2007, the assets in the AP Funds totaled SEK 898 billion, but they dropped to SEK 707 billion by the end of 2008, a loss of SEK 191 billion, or about 21 % (Regeringen 2009b).

Pension cuts implemented in 2010 were the first since the new system was fully operational in 2002, and they came on the heels of several years of real increases. Between 2002 and 2009, the strong economy had resulted in cumulative pension increases that were 5 % higher than price indexation would have delivered. Indeed, pensions were increased in 2009 by 4.5 % (Regeringen 2009b).

Pensioners groups, led by the largest pensioners' organisation, PRO (*Sveriges Pensionärers Riksorganisation*) strongly criticized the pension cuts. Pensioners were already angry about the non-socialist government's introduction of the earned income tax credit (*jobbskatteavdrag*) in 2007. Pensioners groups, backed by the opposition Social Democratic Party, argued that the tax credit was unfair, because income from pensions would be taxed at a higher rate than income from employment.

The first pension cuts were implemented in an election year, heightening the controversy around the automatic balancing. The non-socialist government responded with legislation in 2009 to reduce taxes in 2010 for pensioners to ease the effect of the cuts, especially for pensioners with the lowest incomes. Despite the tax cuts for 2010, about 80 % of pensioners experienced a cut compared to 2009, averaging 0.7 % after tax (*Dagens Nyheter*, 5 and 7 January 2010). Opposition parties also responded with promises to use tax cuts to ease the effects of automatic balancing. The 2010 tax cuts for pensions were achieved by increasing the basic deduction (*grundavdrag*). The opposition Social Democrats, Green Party and Left Party wanted an even higher basic deduction (Skatteutskottets betänkande 2009/10:SkU24).

Efforts within the consensus-oriented Pensions Group to ease the effects of automatic balancing had begun in 2009. The Pensions Group tasked the National Insurance Agency (*Forsäkringskassan*) to analyse the construction of the balancing mechanism and propose alternatives. The parties quickly agreed on legislation (proposed by the non-socialist government) to reduce large swings in the value of the AP Funds in calculating the balance ratio (Regeringen 2009a). The calculation of the AP Funds' value would now be based on a moving three year average, rather than an annual figure.

The effects of automatic balancing also prompted additional revisions. In May 2015, the Pensions Group agreed on a second modification, with effect in 2017. The Pensions Group argued that the automatic balancing mechanism resulted in unreasonable large swings in the indexation of pension accrual and pension pay-outs. The legislation, passed under a Social Democratic-Green government, means that only one third of the effects of balancing will affect pensions. The new formula applies to both surpluses and deficits: pensions will increase more slowly, and nominal cuts (if they occur again) will be less severe. The implementation date is important because pensions were forecast to increase by 4.7 % in 2016. 2017 implementation would mean that pensioners could claim all of the increase for 2016 (Regeringen 2015).

Since 2013, the balance ratio has exceeded 1.0, and the changes to how the balance ratio is calculated have contributed to steady pension increases. At the end of 2018, the balance ratio (to apply in 2020) was 1.0505 (Regeringen, 2019d).

## **Strengthening Incentives for Individuals to Work Longer**

The reformed pension system's NDC construction introduced very strong incentives for individuals to increase the duration of their working lives. Compared to the ATP pension scheme, the reformed system reflects a very tight link between income-related contributions and pension benefits. There is no formal pension age in the income pension system; individuals may retire any time starting at age 62. Individuals may also draw their pension at different levels (25 %; 50 %; 75 % or 100 %), making it easier to combine income from employment and their pension. The minimum retirement age for the guarantee pension is 65. If individuals are to work longer, legislation concerning individuals' right to continue in employment is crucial. The age at which employers may legally end an individual's employment was increased from 65 to 67 in the early 2000s. This change, in combination with the introduction of the new pension system, has substantially altered the incentive structure for older workers. In 2000, only 22 % of 66 year olds had income from employment, but by 2015, the share had increased to 44 %. The upward trend for 67 year olds is also strong: the share doubled from 18 % to 36 % in the same period (SCB 2019).

There is much more variation in effective pension age than in the past. 65 continues to be the most common pension age, but the share of workers retiring at 65 has decreased. 77.3 % of those born in 1938 retired at age 65, whereas 44.7 % of those born in 1952 did so. The decrease reflects both earlier (ages 61-64) retirement and later (ages 65-71) retirement. (Ds 2019:2, p. 98). In 2012, the average pension age was 64, the highest in the EU. Norway and Iceland had higher pension ages at 65 (Westin, 2016).

Individuals also appear to be more cognizant of the impact of paid employment on their future pension. Participants receive an annual statement from the pension agency that summarizes their contribution record, their notional assets in the income pension scheme, and their assets in the premium pension scheme.

## **Risk Diversification**

The new pension system expands risk diversification by clarifying the role of the AP Funds in the income pension scheme and by introducing the premium pension. The previous ATP system was a defined benefit (DB) scheme based on PAYGO, so the AP Funds financed funding gaps when contribution income was less than the cost of pension pay-outs. The shift to NDC in the reformed pension system means that the AP Funds play a somewhat different role. The AP Funds continue to function as buffer funds in that they supplement contribution revenue in financing pension pay-outs. However, the AP Funds' financial assets are now explicitly part of the income pension system's assets for the purpose of calculating whether the system is in balance.

The introduction of the premium pension is more significant because it means that a non-negligible share of future statutory pension benefits depend on the performance of individually chosen investment funds. As discussed, 2.5 percentage points of the 18.5 % pension contribution are allocated to mandatory individual investment accounts administered by the Swedish Pension Agency. The income earned by these investments is credited to individuals' accounts and is converted to an annuity at retirement, so the majority of retirees receive both an income pension and a premium pension. This construction diversifies risks because the develop-



ment of the income pension depends largely on wage developments while the value of the premium pension depends on investment performance.

The rate of return in the premium pension system has been higher than that of the income pension system since the early 2000's. However, there have been large fluctuations in the average rate of return in the premium pension system, largely because of the global financial crisis. Despite these fluctuations, the cumulative rate of return of the premium pension is higher than in the income pension, despite the fact that employees and pensioners bear more risks than in the previous system.<sup>11</sup>

### **Enhancing Freedom of Choice**

Results have been disappointing when it comes to enhancing freedom of choice within the premium pension system. When the premium pension was introduced in the early 2000's, participants showed a fairly active interest in choosing investment products. This was probably the result of the newness of the premium pension and the extensive information campaign run by the government. Since about 2003, however, few continuing participants and extremely few new participants make an active choice concerning how their premium pension capital is invested. Very few pension savers switch funds (about 6 % in 2017) (Regeringen, 2018a). This has prompted criticism from pensioners groups that argue that the premium pension should be abolished and the capital transferred to the income pension system. A recent problem has been illegal marketing of funds and violations by fund managers of the rule that assets be invested in the best interest of the pension saver. 21 funds have been excluded from the fund catalogue because of irregularities (Regeringen, 2018a).

Problems related to the premium pension (too many funds and too few choosers; fraud; misconduct by fund managers) is the background to the Pension Group's decision to introduce measures to modernize and improve the system. This is part of the "Pension Deal" discussed below. Legislation introduced in 2018 (Regeringen, 2018b) responds to these problems by giving the state more responsibility for the premium pension. The key issue is reforming the fund marketplace to make sure that fund providers follow rules about acting in savers' best interest.

### **3.8 Distributional Aspects of the Reform**

The design of the reformed pension system assumes that average benefits would be somewhat lower than in the old ATP system. This has largely been the case, although the expansion of occupational pensions will no doubt fill some or this entire gap. According to the most recent OECD projections, the net replacement rate for the statutory pension for a person with average earnings will be 53.4 % and 68.9 % for a person with 1.5 times average earnings (OECD, 2019, p. 155). As discussed, occupational pensions have wide coverage and will supplement these replacement rates.

The risk of poverty in old age has risen in recent years and remains somewhat high. According to Eurostat, the at-risk-of-poverty rate (share of over persons 65+ with equivalized net income below 60 % of median population

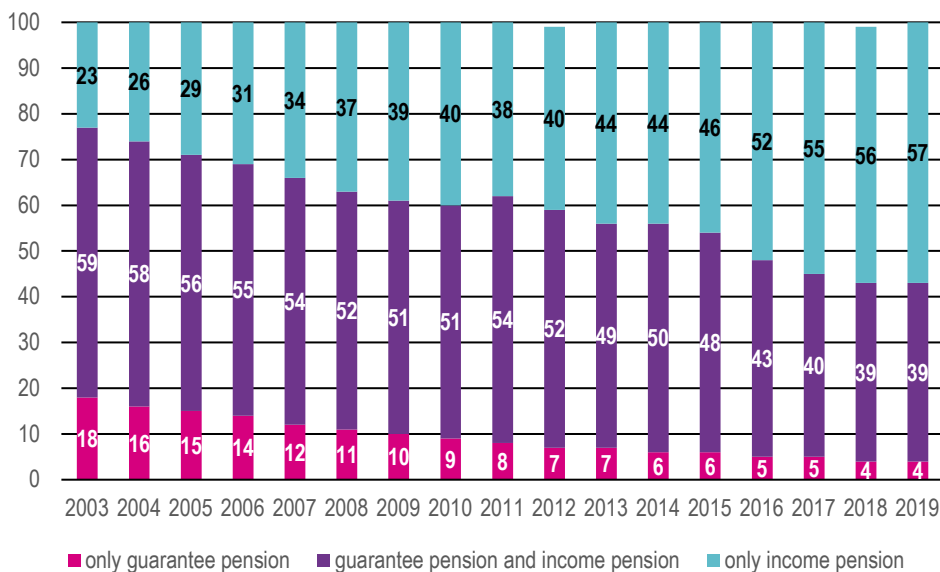
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<sup>11</sup> The rate of return is pre-tax.

income) in 2015 was 16.8 %, compared to 8.5 % in Denmark and 9 % in Luxembourg (www.eurostat.eu). This is largely due to the price indexation of the guaranteed pension and the introduction of employment related tax cuts under the non-socialist governments from 2006-2014. The employment tax credit introduced in 2007 increased net employment income, which then had the effect of reducing the relative net income situation of pensioners compared to employees.

The design of the reformed pension system accelerates labour market trends under way since the 1970s; the effective age of retirement has increased for all groups, but it has increased most for married women. As figures 5 and 6 below show, the share of women pensioners who rely only on the guarantee pension has declined from 18 % to 4 % between 2003 and 2019. Similarly, the share of women pensioners who rely only on an income-related pension (this also includes ATP benefits) has increased from 23 % to 56 % in the same period, reflecting the rapid increase in women's labour market participation since the 1970s. In contrast, men's reliance on the guarantee and income pension in the same period is much more stable, reflecting men's historically high employment rates compared to women.

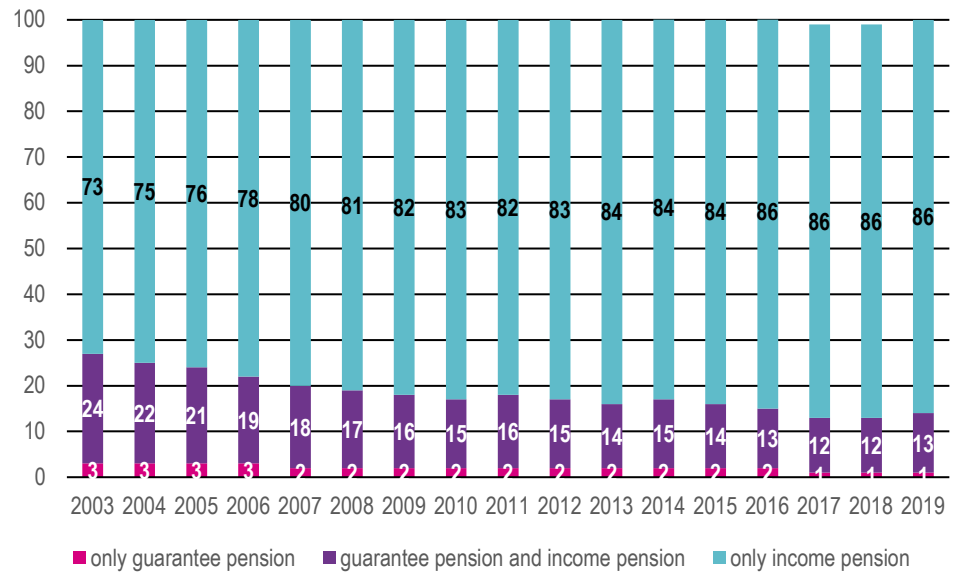
Figure 5: Share of Women with Different Types of Pension, 2003-2019



Source: Regeringen, 2020, p. 23



Figure 6: Share of Men with Different Types of Pension, 2003-2019



Source: Regeringen, 2020, p. 23

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During the discussions concerning the new pension system in the early 1990s, experts pointed to the likely negative effects for women in the new system. In the run-up to the 1994 framework legislation, a study conducted by the National Insurance Board (*Riksförsäkringsverket*) estimated that 2/3 of those studied would be losers in the new system, mainly TCO members and women (SOU, 1994b). The biggest losers would be those who work 20 to 40 years before retirement. The biggest winners would be those who work less than 20 years and receive the new guarantee pension, which would be higher than the old basic pension (*folkpension*). In order to receive the same pension benefits under the new system as in the old, one must work at least 40 years. Women with little or no education fare the best, while women with higher education and fewer working years lose the most, about 17 percent. These calculations were based on a yearly economic growth rate of 1.5 percent. These predictions have largely been borne out. However, because of the gradual transition to the new system, individuals who had time to adjust to the new rules.

Individuals receiving the guarantee pension do not fare well compared to those with an income pension. Guarantee pensions are indexed to inflation, which typically increases more slowly than wages. This means that the value of the guarantee pension has decreased relative to average pensions in the income pension system. This problem is not unknown to policymakers and stakeholders, and is a key element of the pension deal negotiated in December 2017. The current Social Democratic-Green government has already introduced legislation to improve the guarantee pension (see below).

## 4 The Current Politics of Pensions

The reformed pension system enjoys high levels of public confidence and it is supported by a long-standing, stable political compromise that includes more than 80 % of all members of Parliament. The pension reform is based on an agreement between six parties (Social Democrats, Conservatives, Liberals, Center Party, Christian Democratic Party, and the Green Party, which joined in 2014). The parties agreed to cooperate in formulating the principles for the new system, and they formed an implementation group to monitor developments and subsequent legislation. All of the parties to the agreement need to ratify legislative plans. The goal was to create and maintain political stability so that the system would remain financially sustainable.

All of the parties in the Pension Group support the goals of political and financial sustainability. They may disagree on details, but all are committed to maintaining the current structure of the system. For the past several years, the Pension Group has directed the evaluation of several parts of the system. These efforts led to a pension deal in December 2017 intended to guarantee improved and secure pensions. Measures will include policies to increase working lives, eliminate fraud in the premium pension scheme, improve basic provision, and work toward more gender-equal pensions (Regeringen, 2018a, p. 8).

Despite this cross-party consensus, there are important differences across the political parties concerning the future of pension policy. The Social Democratic Party has little enthusiasm for the premium pension and only accepted it as part of a larger political compromise in the 1994/98 reform. The Left Party, which is not part of the Pension Group, is strongly opposed to the premium pension because of its reliance on inherently unstable financial markets and its effects on pension inequality. The non-socialist parties (Social Liberals, Center Party, Christian Democratic Party, Conservative Party) support the pension system because it will result in the long-term decollectivization of the state-run pension funds (the AP Funds) and increase individual reliance on capital-funded provision, as in the premium pension. All parties agree on the importance of keeping pension contributions stable, although the Social Democratic Party has recently proposed increasing the employers' share by 1.3 percentage points in order to finance modest benefit improvements.

Occupational pensions also enjoy wide support and are an important complement to statutory pensions, especially for high earners. Industrial relations in Sweden are based on very strongly organized labor unions and employer organizations. Unions and employers organize the labor market, including wage formation, and the state generally stays out of these processes. There is no statutory minimum wage, and unions and employers strongly defend their independence concerning labor market governance. Unions and employers remain committed to the four sectoral occupational pension schemes that cover 90 % of wage-earners. Private sector schemes made the switch to capital-funded, DC plans in the 1980s and 1990s, and the two large public sector schemes have moved partly in this direction. Employers and unions support these schemes because they are considered to provide secure pension income, and they keep non-wage labour costs stable. Non-wage labour costs – including contributions to occupational pensions; see above – in the private sector are comparatively high in European perspective, but the DC design of pension schemes guarantees that these costs will not increase in the future (Anderson, 2015; 2019).

There is a robust public debate about the future of pension policies. The political parties represented in the Pension Group dominate this debate, largely because they represent 70-80 % of voters, so discussions about the perceived need to reform specific elements of the system are largely conducted within the group. The Social Democratic Party departed from this norm in 2018 when it proposed an increase in the employers' contribution rate and modestly increased benefits for about 60 % of pensioners. The latter proposal is part of the "January Agreement" between the Social Democratic Party, Green Party, Liberal Party and Center Party that forms the basis for the current Social Democratic-Green minority government (Socialdemokraterna, 2019).

As discussed, the future of pension policies revolves around improving basic provision, recalibrating the premium pension system so that it is more user-friendly and resistant to fraud and abuse, introducing measures and incentives that encourage workers to retire later, and reducing the gender pension gap. The pension group monitors the performance of the new system and discusses problems and potential solutions regularly. This does not mean that agreement is without difficulty, but it does mean that there is a consensus about central weaknesses in the current system.

### **The Premium Pension**

As discussed above, the Pensions Group responded fairly quickly to the challenges of the automatic balancing mechanism during the global financial crisis. This debate is largely settled. Responding to challenges presented by the premium pension system has been more difficult, largely because of lingering partisan disagreements about the desirability of the premium pension. As noted, the Social Democratic Party opposed the inclusion of the premium pension in the reformed pension system in the 1990s, but accepted it as part of the larger compromise. Two problems have reopened this debate: pension savers' lack of interest in actively choosing investment funds and the incidence of fraud among fund managers. Pensioners Organizations have also vocally criticized the premium pension scheme, arguing that the capital in the scheme should be transferred to the income pension system to finance higher pensions.

The Pension Group responded with reforms aimed at eliminating fraud and reducing the number of investment choices available to pension savers. The first moves in this direction occurred in 2005, when an official commission of inquiry recommended that the number of fund choices should be radically reduced (from 800 to 100-200; see SOU, 2005). Little progress occurred, largely because of the effects of the global financial crisis. An investigative report in 2013 recommended choosing between two options: no change or reducing the number of fund choices to less than ten (Ds 2013: 35). Recent investigatory commissions have recommended simplifying the choice architecture in order to more effectively pursue the goal of producing returns above wage inflation (SOU, 2016). In April 2017, the Pension Group agreed on a reform strategy focusing on reducing fraud among financial service providers offering investment funds and overhauling the fund marketplace. This strategy was confirmed in the pension deal agreed in December 2017.

In April 2018, the Social Democratic-Green government introduced legislation to implement the agreed approach (Regeringen 2018b). The reform proceeds in two steps. First, financial service providers will be required to meet specific minimum requirements in order to offer their products in the

fund marketplace. These tougher requirements include minimum capital rules, a minimum three year track record, experience outside of the premium pension scheme, and adherence to ESG (environmental, social and governance) criteria. These rules took effect in November 2018. The second stage involves the establishment of a state agency to conduct the procurement process for the fund marketplace. In the past, all funds that met minimum criteria could participate. The idea behind the ongoing reform process is that a new state agency will carefully screen investment funds for inclusion in the fund marketplace, thereby improving the quality of all funds and making it more difficult for pension savers to make "bad choices." An expert commission issued its report and legislative proposal in 2019 (SOU, 2019), and the current government has stated its intention to propose legislation after consultation with the Pension Group.

### **Raising the Target Pension Age**

Discussions about extending working lives have been somewhat conflictual. As in other countries, Swedish policy-makers have responded to increases in life expectancy with proposals to encourage workers to retire later. In 2011, the Pension Group appointed an official commission of inquiry to investigate whether to increase minimum pension ages in the statutory pension schemes. The expert report published in 2013 recommended increasing minimum pension ages and thereafter linking them to changes in life expectancy (SOU, 2013).

The unions in particular are unwilling to accept these measures unless they are accompanied with policies designed to facilitate longer working lives (improvements in work environment, enhanced training). Lingering disagreements prevented further action until the December 2017 pension deal, which bundled an increased retirement age with other measures to improve the adequacy and sustainability of statutory pensions. The pension deal built on the 2013 expert report, proposing that the minimum statutory retirement age should be raised from 61 to 64 and the maximum retirement age be increased from 67 to 70. The deal proposed raising the minimum pension age for the income pension scheme in three steps:

- from 61 to 62 in 2020
- from 62 to 63 in 2023
- from 63 to 64 in 2026

These changes required employment protection law (*lagen om anställningsskydd*) to be revised so that workers would have the right to remain in employment from 67 to 68 in 2020, and from 68 to 69 in 2023. This was implemented in 2020 based on legislation adopted in 2019 (Regeringen, 2019a). In addition, the minimum age for the guarantee pension is scheduled to increase from 65 to 66 in 2023 and from 66 to a new pension age linked to life expectancy. Persons with at least 44 years of employment could still draw the guarantee pension at 65 for a transitional period.

In February 2018, the Minister of Social Affairs established an expert group to make concrete proposals, which it delivered early the following year (Ds 2019: 2). The report built on previous efforts, but also introduced the concept of the target pension age, or '*riktålder*', automatically linked to changes in life expectancy. By 2019, average life expectancy had increased by two years for women (to 84) and four years for men (to 81) since 2000. By 2060, women were projected to live on average until 88 and men until 86

(Ds 2019: 2, p. 95). In May 2019, the government proposed legislation putting the experts' proposals into practice (Regeringen, 2019b). Parliament adopted the legislation in October 2019, and it took effect on 1 December 2019. The retirement age remains flexible (starting at 62), and the target pension age will be used to calculate this minimum age for future cohorts of pensioners. The target pension age is average life expectancy minus three years.

### **Improving Basic Provision**

It has not been difficult for the pension group to agree on how to improve basic provision, and legislation was adopted in October 2019 to achieve this. Discussions concerning the adequacy of basic provision have continued since the reformed pension system was implemented in 2000. In particular, the design of the guarantee pension has attracted criticism from the unions and pensioners groups because it is indexed to inflation, rather than wage growth. This means that the real value of the guarantee pension in relation to the income pension decreases over time, especially in periods of rising real wages. In addition, the non-socialist government's introduction of the earned income tax credit (*jobbskatteavdrag*) in 2017 (and expanded later) has widened the gap in net income between pensioners and workers. Tax cuts for pensioners (discussed above) partially offset this difference, but they did little to compensate for slower price indexation compared to wage indexation. Between 2003 and 2019, guarantee pensioners experienced 15.7 % real increase in their pensioners, while wage-earners' real incomes increased by 44.6 % for the same period (Regeringen, 2019c, p. 15).

The Pension Group agreed legislation was necessary as part of its agenda for "Equal Pensions" (*jämställda pensioner*) set out the previous year because women are much more likely than men to need basic provision (80 % of guarantee pensioners are women). The Minister of Social Affairs appointed an expert group to investigate reform in January 2017. The expert group was charged with evaluating the adequacy of the guarantee pension, housing subsidy, old age support and survivors' pensions. The December 2017 pension deal reinforced this goal by promising a supplement for low-income guarantee pensioners and raising the ceiling for housing supplements. Guarantee pensioners would also be able to combine work with their pension (for wages below SEK 24,000). The expert report delivered in March 2018 (Ds 2018: 8) proposed increasing the level of the guarantee pension, the introduction of a supplement (higher for singles than couples; the supplement would be partially reduced if a pensioner has occupational pension income or net capital income); a higher guarantee pension for later retirement; an increase in the ceiling for housing supplement (from SEK 5,600 to 7,000 per month); and the introduction of a tax-free amount for work income below SEK 24,000 per year. The government introduced legislation in May 2019 (Regeringen, 2019c), and it was adopted in October. The new rules took effect on 1 December 2019.

## Equal Pensions

The Pension Group has also proposed an Action Plan (in 2017) to study the causes of the gender pension gap and propose policy responses. There is consensus within the group and among stakeholders that the labour market and social insurance systems should be based on individual economic independence and the participation of all adults, including parents, in the labour market. However, more than four decades after the introduction of individual taxation and wide-ranging policies to promote gender equality, women's pensions continue to be lower than men's, largely because differences in labour market participation. On average, women bear more family responsibilities than men (part-time work; career interruptions; employment in the public rather than private sector), and this is reflected in the lifetime incomes that are the basis for pension benefits (Ds 2016: 19). The Pensions Group does not propose measures aimed at changing these employment patterns, and instead has focused on two areas where adjustments in pension policy are considered reasonable and appropriate: improvements to basic provision (discussed above) and changes in premium pension rules concerning the transferability of pension rights between spouses and partners. This was already part of the reform discussions in the early 1990s, but the idea was scrapped.

The Action Plan also includes initiatives aimed at improving knowledge about the labour market causes of the pension gap and the feasibility of recalibrating how child years and higher education are translated into pension rights.

## 5 Evaluation

The reformed pension system performs well in two important areas: strengthening incentives for individuals to increase the volume and length of their employment and enhancing the long-term financial sustainability of the system. The effective age of retirement has increased (Westin, 2016), and Sweden now has the highest effective retirement age in the EU. The contribution rate has remained stable at 18.5 % of earnings below the benefit ceiling since the reform, and there is consensus concerning the controlling of pension costs by using the NDC approach.

The current pension system is, however, open to criticism because of the effective decline in replacement rates since 2000. The 1994/98 reform was based on the assumption that most pensioners would receive about 60 % of their final salary from the statutory system, but the results are mixed. Only those born 1953 and after fall completely under the new system, so the available research concerns the transition generations, or those for whom both the old ATP and the new system applies (cohorts born 1938 to 1953).<sup>12</sup> For these generations, women in general received lower benefits than in the old system because the best 15 of 30 years rule benefitted women more than men because women are more likely to reduce their working time in order to meet family responsibilities (Granbom, 2017).

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<sup>12</sup> Those born in 1938 receive 16/20 of their pension from the old ATP system and 4/20 from the new system. For each successive cohort up to 1953, the share coming from the old system decreases by 1/20.



Increases in the value of the guarantee pension have also lagged behind those of the income pension because the former is indexed to inflation and the latter is indexed to wages. This has created a dilemma for the Pension Group, especially the Social Democratic Party. On the one hand, basic provision should be high enough to secure an acceptable standard of living (*skälig levnadsstandard*) for those with incomplete earnings profiles. On the other hand, the level of the guarantee pension and other elements of basic provision (i. e. housing supplement) should not violate the core principle of the income pension scheme: lifelong employment income should determine the level of the pension, so a person who has worked their whole life should get a better pension than someone with basic provision. The difference between the highest level of basic provision and the lowest level of the income pension is referred to in public debate as the "respect distance" (*respektavstånd*), and a key argument in public debate is that employment will start to lose respect and legitimacy if the pension it generates is close to the level of basic provision. The current Social Democratic-Green government referred to this dilemma as a "balancing act" between protecting against social exclusion and honoring the principle that lifetime income determines the pension. In other words, work has to pay, and the income pension system must rest on strong legitimacy. This means that the income pension (and premium pension) for persons with long employment records should be significantly higher than the level of basic provision. The legislative proposal concerning improvements in the guarantee pension and housing supplement explicitly states that basic protection cannot be "too high." (Regeringen, 2019c)

LO (Swedish Trade Union Confederation), TCO (Swedish Confederation of Professional Employees) and SACO (Swedish Confederation of Professional Associations) did not explicitly support the 1994/98 reform but they tacitly accepted it (Anderson and Immergut 2007). The three major union confederations accepted the necessity of improving the financial sustainability of the pension system, even if they disagreed with some elements of the 1994/98 reform. TCO was especially critical of the deterioration of white-collar workers' pensions. Evaluations among the blue-collar unions have varied, largely because the switch to NDC based on lifetime earnings benefits blue-collar workers with long working lives and slowly increasing wages, so some groups do better in the new system (see Anderson and Immergut, 2007 for details).

In the two decades since the reform was implemented, the unions have called attention to the long-term decrease in replacement rates since the 2000s. TCO is particularly concerned about the long-term decline in pensions, especially the goal of providing only 60 % of final salary (TCO, 2019a). LO and TCO have called for increases in the contribution rate to the income pension in order to improve replacement rates, and they are pushing for improvements in the way that social insurance benefits (parental insurance, sickness insurance, disability benefit) count for pension accrual (TCO, 2019a; LO, 2019a). At present, only the cash amount of the benefit is pension-carrying, not the underlying income on which the benefit is based. In addition, LO is critical of the current proposals to increase the retirement age unless there is an increase in contributions to the income pension to 20 %, improvements to sick pay and rehabilitation measures, and active labor market policies that would enable older workers to remain employed (LO, 2019b). TCO also opposes several elements of the pension age proposals, especially the speed and level of increases in the target retirement age. This does not give individuals enough time to adjust, and it

complicates collective bargaining. TCO proposes increases in the pension contribution to finance increased pension costs because of increases in life expectancy, improvements in the calculation of pension rights for parental insurance and other income-related benefits (TCO, 2019b).

## **6 The Pension System and the Labour Market**

The Swedish welfare state and labor market are based on full employment and activation. The tax system supports these goals because it is based on individual taxation (since the 1970s), so there are no tax benefits for dependent spouses/partners, and tax splitting does not exist. Social services such as health care, education, and care for the elderly are tax-financed and based on residence. Social insurance (parental insurance, unemployment insurance, sickness insurance, disability insurance, pensions) is earnings-related and despite deteriorations in the past two decades, benefits are fairly generous from an international perspective. There are few derived rights in the social insurance system; the widow's pension has been abolished, but continues to pay benefits to those who qualified under the pre-1990 rules.

Recent reforms of social insurance, particularly the pension system, aim to increase labour supply to offset some of the effects of rising life expectancy. This means that the pension system is designed to create strong incentives for individuals to increase their working hours and to extend their working lives. As discussed, the planned increase in the target retirement age requires complementary legislation concerning the highest age that employment protection law applies to, as well as adjustments to collective agreements.

### **6.1 Recent Labour Market Performance**

2018 was a stable year for the labor market. 29 of 668 national collective agreements expired during 2018 and none led to conflict. 2017 and 2018 were marked by good economic growth. This did not lead to high wage increases, however. Wages increased by 2.6 % in 2018, but because of inflation real wages increased only 0.5 %.

The Swedish labour market has experienced robust growth since the end of the global financial crisis. Profitability in the private sector has recovered since the lows of 2013 and 2014. Falling unemployment has led to a 6 % unemployment rate in 2018. Although collective bargaining coverage is higher in Sweden than elsewhere, it has been decreasing modestly. Employer organization remains stable, but blue-collar private-sector unions are slowly losing members (Medlingsinstitutet, 2019, p. 12).

Positive labor market developments have their origins in the "Industry Agreement" signed in 1997 which introduced a new system of conflict resolution and coordinated wage bargaining. The central idea driving this approach is the assumption that the competitive industrial sector should lead wage bargaining and that rising real wages should be combined with high employment. The principle of industrial sectors setting norms for wage formation and the rest of the economy has deep roots in postwar economic policymaking, but it got a new start in 1997. The background was two decades of industrial conflict and uncoordinated bargaining that led to wage

inflation. Elvander (2002) calls the Industry Agreement the most important reform of industrial relations since 1938. In addition to the industrial sector leading wage bargaining, the agreement set up a Mediation Institute in 2000 to provide impartial mediation (see Regeringen 1999). Several institutional arrangements support this approach: coordination of LO unions, cooperation within the employer's organization and municipal employers (Medlingsinstitutet 2019, p. 16).

## **6.2 Labour Market Challenges to the Pension System**

At present, the Swedish labour market presents two challenges related to the pension system: the gender segregation of the labour market and the labour market integration of migrants, especially asylum-seekers from outside Europe.

Despite comparatively high female labour market participation rates, there is a persistent but slowly shrinking gender pension gap that is rooted in women's tendency to work part time and in the public sector (compared to men). Women earn on average 11.3 % less than men. Controlling for occupation, level of education, age, sector, and working time the unexplained difference drops to 4.3 % (Medlingsinstitutet, 2019, p. 12). As discussed above, the Pension Group acknowledges this problem, but there is consensus that the income-related pension system should not be used to correct for labour market inequalities. However, the strong overrepresentation of women among guarantee pensioners was the basis for the Pension Group's initiative (followed by legislation) to increase guarantee pensions modestly.

It is difficult to determine the effects of migration on the pension system. On the one hand, it will increase government spending on basic provision. Migrants who establish residence in middle age (unless they are EU/EEA citizens) will not have enough time to build up sufficient income-related pension rights to lift them above the maximum level of the guarantee pension and housing supplement. Even younger migrants will face this problem because of the difficulty migrants face establishing themselves on the labour market as young adults. On the other hand, migration of low-skill groups from outside the EU may have a downward effect on average wages over time, which will affect the income pension system because average income in the economy is the basis for the internal rate of return in the income pension system (i. e. the value of notional assets as reflected in the income index). Even though the influx of workers into the labour market strengthens the income-related parts of the pension system, this process has the potential to pull down average income pensions (Regeringen, 2019a, p. 11).

### 6.3 Is Sweden Best Practice?

The Swedish pension system rests on three best practices: individual taxation; individual benefit entitlement; and stable, encompassing collective bargaining. Sweden abolished joint taxation as part of a tax reform in 1970 (with effect in 1971). Joint taxation was required until 1966, but was voluntary between 1966 and 1971. The shift was part of a larger tax reform designed, among other things, to increase labour supply and to promote women's economic independence (SOU, 1964; Regeringen, 1970). Individual entitlement within the statutory and occupational pension systems reinforce the positive effects of individual taxation on labour supply and gender equality. The level of the income pension is entirely dependent on previous labour market participation, so the financial incentives to form a breadwinner-based household are low. As discussed, the highly institutionalized industrial relations system in Sweden rests on very high organization rates amount employers and wage-earners and results in very wide collective agreement coverage. This has two effects: the low wage sector is relatively small, and unemployment has returned to modest levels. In addition, strong labour market institutions are the basis for very high occupational pension coverage.

### 6.4 Pension and labour market policies

As discussed, the pension system is strongly linked to labour market policies and labour market performance. This tight link is firmly embedded in the political compromise underpinning the 1994/98 pension reform: all parties to the compromise agree that every *krona* of income should result in pension entitlement, and that the indexation of pension accrual and payouts is based on wage developments. The NDC basis of pension accrual and indexation also means that periods of rising unemployment affect pension levels more than would be the case if average wage growth were the basis for indexation.

The design of tax and social insurance systems also encourage individuals to increase their labour supply because they are based on individual income and employment-related entitlements, so there are very strong incentives for all adults to engage in full-time employment. Generous parental insurance and universal access to low cost, high quality child care/preschool substantially reduce the obstacles for parents to combine employment with child rearing. This policy mix facilitates long full-time careers.

The interaction of labour market policies, social insurance and the tax system means that future retirement income will increasingly reflect individual labour market participation and economic performance (the income pension) and investment returns (the premium pension). Compared to the old ATP system, this will undoubtedly lead to increasing income inequality among pensioners, and it will make pension levels more dependent on macroeconomic performance

## 7 Conclusions

Sweden adopted a major reform of its pension system in the 1990s, before the onset of the dot.com bubble in the early 2000s, the global financial crisis that began in 2008, and the current COVID-19 pandemic. Indeed the Swedish economic crisis of the first half of the 1990s was the backdrop to the initial cross-party compromises about the contours of the new pension system. A central goal of the reform, supported by nearly all parties in the Riksdag, was to insulate the pension system from demographic and economic fluctuations. The NDC construction of the income pension largely achieves this, but it does so by placing more risk on individual workers and pensioners.

One of the keys to the sustainability of the 1994/98 reform is the willingness of the five parties behind the original agreement to negotiate all modifications to the pension system within the Pension Group and to rely on consensus. This commitment effectively insulated pension policy change from electoral politics by reducing incentives for parties to defect from the Pension Group and pursue an independent course. Sticking to the agreement has not been easy, however, as recent discussions concerning the premium pension, the cuts triggered by the automatic balancing mechanism, and the level of basic provision demonstrate. In particular, the influence of pensioners groups and the trade unions has been minimized, and there is concern that public debate about the future of the pension system has been stifled (Weaver and Willén, 2014).

The willingness of the five main political parties to de-politicize pension reform and undertake far-reaching policy changes also rested on two important preconditions. First, the capital in the pension system's buffer funds (the AP Funds) could be used to finance some of the costs of the transition to the new pension system. This kept the contribution rate stable at 18.5 % of the pensionable salary and facilitated the establishment of the premium pension (Anderson and Immergut, 2007). Second, the occupational pension sector covers 90 % of workers, providing important top-ups for average earners and substantial income replacement for those with earnings above the statutory pension ceiling. If the AP Funds eased the transition to the new system on the financing side, the occupational pension system did the same on the benefit side by helping to cushion potential negative effects concerning pension generosity.

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