

# Old age pensions in Sweden

## FACT SHEET

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### History

Sweden introduced a public pension scheme in 1914. The scheme, which consisted of an old-age pension plan and disability insurance, was compulsory and applied to virtually the entire population. The pension was small and was payable from the age of 67, earlier if the recipient was unable to work.

### The national supplementary pension system

Before the reform of the basic retirement pension in 1948, old age for many Swedes was synonymous with a life in poverty. The new basic retirement pension represented a great improvement, but retirement still meant a significant fall in a person's standard of living.

The national supplementary pension scheme, which was introduced in 1960, was a pay-as-you-go (PAYG) system. When it was launched an important objective was to raise the standard of living for the elderly as quickly as possible. The productive population paid for their pensions directly via contributions. In order to build up a buffer fund during an initial period, larger contributions were levied than were necessary to cover current pension payments. The surplus was deposited in the National Swedish Pension Fund. The intention was to create a compulsory income-related scheme based on the loss of earnings principle. For the first time ever, Sweden had a universal system in which a pension was regarded as deferred earnings and not as a hand-out. The size of a person's national supplementary pension depended on his or her income during the fifteen years with the highest earnings. To qualify for a full national supplementary pension, a person had to work for 30 years. The national supplementary system also provided security of income in the form of a basic retirement pension. To qualify for a full basic retirement pension a person must have either worked for 30 years or lived in Sweden for 40 years.

Retired people living on a small pension may also qualify for housing supplement for pensioners or special housing allowance. In 2000, a full basic retirement pension for a single person amounts to SEK 2,928/month, while retired, married couples receive SEK 2,394 per person/month.

### Why Sweden needed a new pension scheme

The number of old-age pensioners in proportion to the working population is rising. Furthermore, life expectancy is on the increase, which means that people

receive a pension for a longer period. The increased cost of pension payments combined with low growth are the main reasons for the reform of the pension scheme.

There are also other reasons. The national supplementary pension scheme favours people with erratic earnings trends or those who work for only a short period, and is unfair to people whose income develops more consistently and who work for a long period. This is due to the 15/30 rule. Two persons who have the same life-time earnings may receive quite different pensions, although they have paid the same contributions into the system. If the previous pension scheme had been retained, it would have been necessary to raise contributions quite substantially. By the year 2025 or thereabouts, the costs of pensions under the old rules would have amounted to around 36 per cent of the total payroll.

### The reformed pension system

In June 1998, the Riksdag (Swedish parliament) approved a proposal for a new pension scheme based on an agreement between five political parties – the Social Democrats, the Moderates, the Liberal Party, the Centre Party and the Christian Democrats. The new provisions came into force on 1 January 1999. The reformed pension scheme has a number of different components: an income-related pension, a prefunded pension, and a guaranteed pension. The new system replaces the basic retirement and national supplementary pensions completely for persons born later than 1953, while some parts of the old system will continue to apply to persons born between 1938 and 1953. In addition to the new scheme, most people qualify for contractual pensions/occupational pensions and may have personal pension savings. The first payments under the reformed system will be made in 2001.

Under the new system, a person's pension is based on his or her full life-time earnings. A guaranteed pension provides basic security of income. Pensions are linked to economic growth in Sweden. The scheme is designed to be viable in the face of demographic change, retirement age will be flexible, and time devoted to caring for children, military service and studies also confers pension rights.

The size of the public pension is determined by a person's life-time earnings, and not as was previously the case by the 15 best earning years. It will also be

determined by general earnings trends on the Swedish employment market. Favourable developments mean higher pensions, while a decline will have a negative effect. The guaranteed pension is intended to provide basic protection for people who have had little or no earned income. It is also payable as a supplement to the income-related pension. The prefunded, or premium pension, is that portion of a pension which a person may invest in a fund of his or her own choosing. Under the new scheme, retirement age is flexible. To enable people who so wish to work beyond the age of 65, the original pension agreement contained a clause allowing people to work until they reach the age of 67. Housing supplement for pensioners will continue to be available.

### **Contributions**

Pensions in the new scheme are based on a fixed contribution amounting to 18,5 per cent of pensionable income. In cases where a person has received social insurance payments such as sickness or unemployment benefit, the government rather than the employer pays the contribution. The individual pays a general pension contribution on all types of income.

### **The income-related pension**

Sixteen per cent (16 %) of the contribution is deposited to pay for current pensions in a pay-as-you-go system (PAYG). This part goes directly to the people who are retired now.

### **The prefunded pension**

Two point five per cent (2.5 %) is transferred to an individual prefunded pension account. The contributions – or premiums – are deposited in a special fund. This pension is known as the prefunded or premium pension. Individuals are free to select their own fund manager to handle this part of their pension. The size of the pension will depend *inter alia* on the return on the fund. The contributions of persons who do not actively select an asset manager will be invested in the Premium Savings Fund within the National Swedish Pension Fund, and will be managed by the Seventh Fund Board. The premiums of those persons who prefer to rely on a state-run asset manager will be deposited in a special fund – the premium choice fund. These assets are also handled by the Seventh Fund Board.

### **The guaranteed pension**

Persons who have not earned any or only a few pension entitlements have in principle the right to a guaranteed pension, which is payable from the age of 65. The guaranteed pension will amount to 2.13 price base amounts for single persons and 1.90 price base amounts per person for married couples. For purposes of comparison, the basic amount in 2000 is SEK 36,600.

### **Link to economic growth**

When a person retires the amount recorded on his or her earnings-related pension account represents that person's aggregate pension assets in the PAYG system. Pension payments are to be indexed under a new regime of flexible indexation based on a notional future growth rate of 1.6 per cent. If real growth is higher than this 1.6 per cent norm, pensions will be adjusted upwards by the rate of real growth in excess of 1.6 per cent. If real growth is lower than the norm, full compensation will not be made for price increases, which means that pensions will fall in real terms.

### **A stable system**

The later a person retires the higher his or her pension will be. When a person retires his or her aggregate pension assets in the PAYG system are divided by a coefficient. This is based on the person's remaining life expectancy, that is to say, the number of years that pensioners of the same cohort are expected to receive pensions. This coefficient is also based on the notional, annual growth factor of 1.6 per cent.

### **Flexible retirement age**

Both the income-related pension and the prefunded pension are payable when a person reaches the age of 61. There is no upward limit. Full or partial pensions are available.

### **Pension entitlements**

Income up to a limit of 7.5 higher price base amounts will carry pensions rights. In 2000, 7.5 higher price base amounts correspond to a monthly salary of SEK 23,312. Some of the pension points earned in the old ATP system will be converted into pension entitlements. Pension rights are also awarded *inter alia* to people who have been ill, unemployed or draw a disability pension. Time spent caring for young children, military service and studies also confers pension rights.

### **New Government bills**

Basic pensions payable to persons born 1937 or earlier are to be adapted to the reformed pension system. It has been proposed that a transitional guarantee pension should replace today's basic system for old-age pensioners, namely the system involving basic retirement pension, additional pension supplements, and the special basic tax deduction. A Government bill to this effect was presented in May 2000.

Survivor's pensions are also to be adapted to the new pension system in another Government bill, presented in March 2000.

Officials at the Ministry are now working to adapt the disability pension and housing supplements for pensioners to the new pension scheme.

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