Revisiting the Market for Social Insecurity

by Jan Hagberg och Ellis Wohlner

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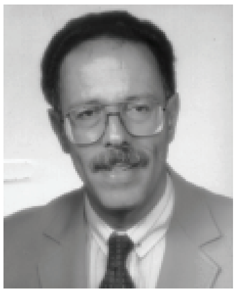

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The Swedish national pension system has been thoroughly revised. The new old age pension system is basically ***earnings-related,*** *but contains a guaranteed* ***minimum pension*** *for those who have no or only a low earnings-related pension. The level of that minimum pension was fairly high when introduced in 1994, though its relative value has already diminished and will continue to gradually, but significantly, do so in the future due to its being indexed according to the cost of living rather than to wage development. The* ***earnings-related*** *scheme consists of two parts, a pay-as-you-go NDC (notional defined contribution) part and a fully funded FDC (funded defined contribution) premium reserve part. We wrote an article on the revised national pension system which was published in the Scandinavian Insurance Quarterly in December 2002 (NFT 2002:4). Many articles written by Swedish and international experts have followed.*

Our original article, "The Market for Social Insecurity", was actually written for and first published on the web site of Nordic News Network (www.nnn.se). This past winter, in light of the subsequent series of articles in NFT and the six years that have gone by, the editor of NNN asked if we would review our article and perhaps write an updated version. After a careful review, we found that the judgements we made in the original article were still valid and that no new version was required, only a follow-up on developments since 2002.

In late April of 2008 we briefly described the evolution of the system *(then vs now):*

- Total administrative costs in percent of total benefits: 0.55 % in 1999 vs **2.18** % in 2006 (0.8 billion SEK in 1999 vs **3.9 billion** SEK in 2006).
- Number of funds in the premium reserve scheme: 700 funds (in 2002) vs **780 funds** (in 2006).

Jan Hagberg and *Ellis Wohlner* are both retired from senior management positions at large Swedish insurance companies. Both are members of the Swedish Society of Actuaries, where Hagberg has served as Chairman, and of the International Actuarial Association. Wohlner is also a member of the (American) Society of Actuaries and of the American Academy of Actuaries.

- Percentage of new savers actively choosing funds other than the "default" fund: 14.1 % (in 2002) vs **8.0** % (in 2006).
- Only **2.7** % of savers changed funds more than once in 2006.
- As foreseen, there is little understanding of the complex new system; a recent public survey reported that only **22** % of the 5.6 million participants even ***claimed*** to understand their individual annual statements.
- Public debate has focused on ways to
  (1) reduce the number of funds in the system,
  (2) improve the pedagogics of the individual statements, and
  (3) introduce mandatory "personal economics" courses in the schools;
  rather than on important basic changes.
- While the "automatic braking mechanism" has not actually hit the system any year, it has been very close to doing so and has only been avoided thanks to a booming economy the past few years. What the reaction will be to reduced pensions when the "brake" inevitably does hit is unknown. The Minister of social insurance when the "brake" was added to the system claimed that it was a tool for almost unimaginable circumstances, such as a war close to Sweden with large numbers of refugees or an extreme global economic crisis, and was only added for the sake of completeness.
- The new system's defined contribution nature makes comparisons very difficult, but various studies have confirmed that pension benefits under the new system are gradually reducing relative to the old system; according to the Swedish Social Insurance Agency, a **drop** of about **10** % in the first 12 years, with further reductions expected.

Also important to note is that the new system was designed for a labor market with "full employment as a political objective", as Sweden had had from the end of World War II until 1990 (unemployment was usually under 2 %), and not for the labor market that Sweden has had since then. The unemployment levels which Sweden has since had, particularly during the 1990's, are permanently reducing future pension levels from the national system for many who will receive pensions calculated only according to the new rules. This is especially so for many younger persons who have had difficulty in getting established on the labor market during these years of much higher unemployment rates (up to 8 % in general, with rates in some years of up to 18 % for those under 25 years of age). These younger people will never be able to work enough to compensate for their early losses of pension rights. A societal problem has been tranformed into an individual problem. Talk of "incentives" is meaningless for those affected, since all they can hope for is the guarantee minimum pension. Scarcely a fair system between generations.

Supporters of the new pension system allege that there is great international interest in the Swedish system, for both the NDC and FDC parts. We can however observe:

1. That there are hardly any economically well-developed countries that have copied the Swedish system. Italy and Germany are usually referred to as examples but they are not really comparable with Sweden. Italy has such a long transitional period that politicians will have time to reassess their positions before anything definite can be said. In Germany, the politicians are forced to make a separate decision on the consequences of the braking mechanism before pension levels can eventually be affected.
2. That major international marketing efforts are being made through the national development assistance agency Sida (Swedish International Development Cooperation

> Agency) even to countries that lack the financial infrastructure and/or the overall system structures which would be needed to copy the Swedish system.

Early on in the investigations preceeding introduction of the new system, supporters used wholly unrealistic yields for the FDC-part in order to arrive at acceptable overall pension levels. Unembarassed, they assumed yield levels that over time, and on average, clearly exceed expected growth in the economy as a whole.

A reason for the creation of the national pension system in the United States – Social Security – was that due to the stock market crash in 1929 it was wished to make pensions independent of stock market fluctuations. In today's Sweden, the designers of the new system have instead attempted to make every citizen into a market speculator. But the response has been very negative. Every day can be regarded as a massive gallup poll in which the answer is: "We don't want to!" And the only response from the system's supporters is to reproach the nay-sayers for not taking responsibility for their own pensions! Not surprisingly, the powerful economic interests involved that benefit so greatly from the FDC-part and seriously inflate administrative costs – banks, insurance companies, mutual fund companies, etc – continue to seek an even greater role and strongly resist any reforms that would instead actually benefit the people whose pensions are involved.