The Swedish National Pension System

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Sweden’s National Pension System – A Summary

Following a long political process, on 8 June 1998 the Swedish Riksdag adopted a decision on a new system for retirement pensions. The principal reason for reforming the pension system was that the cost of pensions had increased while growth was low. But there were other reasons too. The National Supplementary Pension system, ATP, was unfair, for example, to people who had had low income growth and worked over a long period of time.

The pension system has entered into force gradually and applies fully as from January 2003.The social insurance offices, the National Social Insurance Board and the Premium Pension Authority administer the system.

Who is covered by the Swedish pension system?

Social insurance can be divided into two different types of benefit – work-based and residence-based. Work-based benefit is linked to income while residence-based is general and linked to residence.

For a person to be covered by the Swedish pension system, he/she must be covered by Swedish social insurance legislation. This can be either through residence in Sweden or employment in Sweden (for entitlement to a pension a certain minimum income is required, see page 10). If a person stops working or takes up work in another country, he or she retains the pension rights earned in Sweden.

Lifetime earnings principle, pension contributions and pension rights

The lifetime earnings principle is fundamental to the pension system. This principle means that the value of all paid pension contributions – contributions paid in the course of working life – is equivalent to what we receive as pensioners in the form of pension.
For those born in 1938 or later pension rights can be earned throughout their lives.

Pensionable incomes are wages and payments from the social insurance system and unemployment insurances. The insured party pays a general pension contribution of seven per cent of his/her wage plus any payments from the social insurance system and unemployment insurance to the pension system. This contribution is paid for incomes up to 8.07 income base amounts[1], which is the highest income for which pension is credited.
In a system based on lifetime earnings, loss of income leads to lower pension. However, from the point of view of distribution policy, society has an interest in compensating for pension reduction due to certain forms of loss of income. Compensation may be full or partial. Those who have small children, those who are studying, persons doing their national service or drawing sickness or activity compensation (previously disability pension) are

[1] The income base amount for 2003 is SEK 40 900

entitled to such compensation. In some cases pension rights are calculated on a notional amount so that the loss of income will not yield a poor future pension. These amounts are an estimated base and hence not actual income. Notional incomes of this type are called *pensionable amounts.* They are calculated as an addition to actual income for the following categories:

- persons caring for small children
- persons who are studying and are receiving study grants
- persons doing their national service or the equivalent
- persons whose income is in the form of earnings-related sickness or activity compensation.

The insured parties, their employers and in certain cases the state pay pension contributions to the pension system. The pension contribution is 18.5 per cent of the pension base. The pension base consists of pensionable income and pensionable amounts.

Employers pay an old-age pension contribution of 10.21 per cent of the employee's wage to the pension system. The contribution is paid for the whole salary. This means that the share that exceeds the ceiling of 8.07 income base amounts is a tax paid to the public treasury and not to the pension system.

How is it possible that pension contributions and pension rights are 18.5 per cent of the pension base when the contribution in most cases adds up to 17.21 per cent?

The explanation is that the national pension contribution of seven per cent is deducted from a person's income when the pension base is calculated. This means that the maximum pension base is 93 per cent of 8.07 of the income base amount, that is to say 7.5 income base amounts.

Income pension and premium pension

The pension system is largely a PAYG system, that is to say an insurance system in which the contributions paid in a year cover that year's disbursements. The name derives from the system's redistribution of incomes from the working population to the retired generation. The pension contribution is 18.5 per cent. 16 percentage points of the pension contribution are used for the PAYG system, that is to say to pay the year's pensions in the PAYG system. The remaining share of the contribution, 2.5 percentage points, is deposited in an individual premium pension account and accrues interest.

The pension from the PAYG system is called *income-based pension.* For each pension-saver, pension rights are registered annually equivalent to debited contributions. Total pension rights are called pension balances and they are adjusted upwards every year to reflect income growth in society. On retirement, the pension balance is the total adjusted pension rights from the PAYG system.

The balance on the PAYG system account does not correspond to any money saved but is registered for the individual. When pension is drawn, it is the working population that finances payment with their contributions.

On retirement, the total pension balance in the PAYG system is divided by the so-called *annutisation divisor.* This is based on the statistically remaining average life expectancy at the time of retirement (the same for men and women) and a notional future growth factor (norm) of 1.6 per cent (the higher this norm, the higher the initial pension). The pension balance divided by the annutisation divisor gives the annual income pension. The later the insured party retires, the higher will be his/her annual pension since remaining average life expectancy and the annutisation divisor decrease. The income pension is always paid for life and is calculated in the same way for women and men.

The remaining share of the contribution, as mentioned above 2.5 percentage points, is deposited in an individual pre-paid pension account. Unlike income-based pension, this share always corresponds to money actually saved. The growth of this money entirely depends on the capital funds chosen by the pension-saver and the returns the funds yield. The pension from this system is called a *premium pension.*

The balance on the premium pension account is the basis for the amount of pension from this system which, like private pension insurances, is calculated applying actuarial principles. The premium pension is always paid for life and is calculated in the same way for women and men.

Balance and capital

In the income pension system, the sum of all pension rights and all interest is called the *pension balance.* In the premium pension system, the sum of all pension rights and changes in value is called the *premium pension capital.* The different designations have been chosen *inter alia* in order to stress that the asset the pension balance represents for the insured party is not the equivalent of fund capital. This, however, is the case regarding premium pension capital.

Guarantee pension

Anyone who has not him/herself managed to earn an adequate pension is assured a top-up *guarantee pension.* This compensation is financed via the central government budget. Guarantee pension can be paid as from the age of 65 at the earliest to those born in 1938 or later. Full guarantee pension amounts to 2.13 price base amounts[2] for single people and 1.90 price base amounts for married persons.

The size of the guarantee pension is partially adjusted to take into account other pensions from the national pension system. It is also adjusted against other pension income (for example widow's pension). It is not adjusted against occupational retirement pensions or private pensions or other earned income.

Those born in 1937 or earlier have as a rule already started to receive pension in accordance with the previously applicable rules. Their pension was recalculated on 1 January 2003 and for these pensioners basic protection is in the form of a transitional guarantee pension under slightly different rules.

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[2] The price base amount for 2003 is SEK 38 600

Earnings-related pension

Insurance based on work or residence

For a person to be covered by the Swedish national pension system, he/she must be covered by Swedish social insurance legislation. This means he or she must either reside or work in Sweden (for entitlement to a pension a certain minimum income is required, see next page). If a person stops working or takes up work in another country, he or she retains the pension rights earned in Sweden.

Social insurance can be divided into two different types of benefit: work-based and residence-based. The work-based benefits are linked to income while the residence-based are general and linked to residence. A person living in Sweden is, for example, entitled to a guarantee pension and under certain circumstances a survivor's pension and also to sickness or activity compensation.

Persons working in Sweden – including non-residents – and credited with pension rights, are also entitled to income-based old-age pension and under certain circumstances to survivor's pension and sickness or activity compensation.

Those who have worked in Sweden and been credited pension rights are always entitled to income-based old-age pension wherever they live. Only those residing in Sweden receive a guarantee pension. However, under EU rules, a guarantee pension may be paid to persons living in another EU/EEA country. By virtue of bilateral agreements with certain countries outside the EU/EEA area, a guarantee pension may be paid under certain circumstances to persons living in one of these countries.

Old-age pension is calculated on pensionable income and amounts throughout life (lifetime earnings principle). The annual pension rights are equivalent to a total old-age pension contribution of 18.5 per cent of the pension base. Pensioners get back the sum of pension contributions plus "interest".

All persons born in 1938 or later who have had pensionable income may receive two different kinds of earnings-related old-age pension, *income pension*, and *premium pension.* Persons born between 1938-1953 may also receive *supplementary pension.*

Income pension

16 per cent of the pension base is allocated to income pension. The balance on the individual's notional account for income pension is recalculated annually taking into account changes in the *income index (see page 21).* The balance is also recalculated taking into account the insured party's share of survivor's bonuses and the cost of administration. The result of this recalculation is "interest" in the income pension system.

Supplementary pension

Those who were born during the period 1938-1953 will receive part of their pension according to the old rules. That part of the pension is called supplementary pension. The older the person is, the greater will be the share of the earnings-related pension received by him or her in the form of supplementary pension. Income pension and premium pension will then be correspondingly lower. Those born in this period may only receive supplementary pension if they make equivalent claims for income pension.

Premium pension

2.5 percentage points of the contribution go to the premium pension. This money is deposited in an individual investment account. The balance on the premium pension account changes according to the return on the capital funds chosen by the pension-saver. As in the case of the income pension and supplementary pension, premium pension is paid for life. Partial pension claims can also be made. The size of the pension is calculated in accordance with actuarial principles and is calculated at the same level for women and men.

How pension is earned

Pension rights can be earned as from the age of 16. This age limit will be abolished on 1 January 2004 and the change will apply retroactively from 1999. There is no upper age limit for earning pension rights for those born in 1938 or later.

The current limit for liability to submit a tax return on income is 42.3 per cent of the price base amount[3] or just over SEK 16 300. Thus, income up to this limit is not pensionable income and does not entitle an employee to pension rights. However, when the employee has crossed this threshold, he/she is entitled to pension rights from the first krona. Employers pay a contribution on employees' incomes of SEK 0–16 300 irrespective of whether or not the employee crosses the income threshold.

Qualifying ceiling

Only pensionable income up to a certain level confers pension rights. The ceiling for pensionable income was 7.5 higher price base amounts up to and including the year 2000. It subsequently became 7.5 income base amounts. This means that nowadays the ceiling is calculated on the basis of general income development instead of price development. 7.5 income base amounts is SEK 306 750 for 2003. The qualifying ceiling applies to the whole pension base, that is to say the sum of all pensionable income and amounts. Hence, this includes the notional income calculated, for example, in connection with childcare years, compulsory service, studies and sickness or activity compensation.

[3] The price base amount for 2003 is SEK 38 600

Pensionable income

Income and social insurance benefits such as, for example, earnings-related sickness compensation, sickness benefit and unemployment benefit confer pension rights in the national pension system. Old-age pension contributions are paid for all pensionable income, including social insurance benefits.

In principle all declared taxable income confers pension rights:

- *income from employment* such as wages, fees, taxable emoluments, etc. *Income from other gainful employment* (self-employed persons, etc).
- *Social insurance benefits,* among others earnings-related sickness and activity compensation, sickness benefit, rehabilitation benefit, parental benefit, attendance allowance, unemployment benefit, some forms of study grants and adult study support, life annuity under the Work Injury Insurance Act and certain benefits from *collective occupational insurances.*

Pensionable amount

For reasons of distribution policy, in addition to real income, certain notional incomes confer pension rights too. Notional incomes of this type are called *pensionable amounts.* The State pays the whole contribution to the pension system.
Pensionable amounts are calculated in the following cases:

- For persons with small children, pensionable amounts are calculated for childcare years
- In the case of national service and the equivalent, pensionable amounts are calculated for compulsory service.
- In the case of studies carried on with the aid of financial support in the form of study grants.
- For those who have earnings-related sickness or activity compensation.

Pension rights for childcare years

Pensionable amounts must be calculated for parents of small children. Parental benefit is indeed pensionable income but it does not compensate the full loss of income during the period the parent is at home with the child. Working parents of small children also receive pension rights for the childcare years. Many reduce their working hours to part-time and consequently receive a lower income. The pensionable amount for childcare years is an estimated addition to the parent's pensionable income and other pensionable amounts in addition to those for childcare years. It is calculated in a special way for each year on the basis of three alternatives. The most beneficial alternative for the insured party is selected.

In accordance with the rules applicable to childcare years, only one of the parents receives these pension rights for a specific year. If both parents fulfil the requirements, they are entitled to choose who shall have the pension rights for childcare years. Before the end of January in the year following the childcare year, the parents must notify the social insurance office as to who should receive the pension rights. If they do not do so, the parent with the lowest pension base receives the pension rights.

Adoptive parents, persons who have received foreign children for adoption with the approval of the social services committee, and specially appointed custodians, are also counted as parents. Foster parents on the other hand are not counted as parents.

Pension rights for childcare years apply during the child's first four years. Anyone who has more children during this four-year period only receives pension rights for one of the children for any one year. If childcare years are to result in payment of pension, the insured party must have had pensionable income (or pensionable amount for sickness or activity compensation) for at least five years and earned at least two income base amounts per year. This is called the *earned income requirement.*

Pension rights for compulsory service

Basic military training in Sweden's total defence also confers pension rights. This applies both to military service and civilian service and to general compulsory service. To qualify, the compulsory service must continue for at least 120 consecutive days. As from 1 July 1995 the National Total Defence Service Act is in force. It also applies to women who voluntarily undergo basic training. They are covered by the pension rules for compulsory service too.

If pension rights for compulsory service are to result in payment of pension, the earned income requirement must be fulfilled. The pensionable amount for compulsory service is calculated for each day of service. It is equivalent to 50 per cent of the average pensionable income for all insured parties under 65, divided by 365.

An insured party who is entitled may be credited pensionable amounts in the same year for childcare years, compulsory service, studies and income in the form of sickness or activity compensation.

Pension rights for studies

Some studies also confer pension rights. This applies to those who are studying and for any part of the year have received financial support in the form of study grants. The pensionable amount is equivalent to 138 per cent of the grant the person studying has received that year.

Pension rights for sickness and activity compensation

Sickness and activity compensation confers pension rights for 93 per cent of the assumed future income that is the basis for the compensation paid. This applies to those who have earnings-related sickness or activity compensation or whose previous disability pension has been changed to sickness compensation.

Pension rights

As previously mentioned, pension rights for each and everyone are 18.5 per cent of the pension base. Pension rights for income pension account for 16 percentage points, while. 2.5 percentage points are premium pension rights.

The social insurance office establishes pension rights every year.

- The basis for pension rights is every insured party's *pension base*, that is to say the sum of all pensionable income and pensionable amounts under the qualifying ceiling.

- The social insurance office receives information about *pensionable incomes* from the tax authority since all taxable earned income is also pensionable. It cannot change the pensionable income set by the tax authority. The social insurance office calculates any *pensionable amounts* for childcare years, compulsory service, studies and income in the form of sickness or activity compensation.

To be able to do so, information is needed from the population register, the National Service Administration and the National Board of Student Aid. Insured parties entitled to pension rights for childcare years who have income from abroad that is not pensionable must give notification of these incomes to the social insurance office.

Growth of pension balances

The pension rights for income pension established for a specific year together with pension rights from previous years make up the insured party's pension balance. The pension balance for *income pension* is recalculated every year in three steps:

- The pension balance of those who have died before reaching the age of retirement is distributed among survivors born in the same year (survivor's bonus).
- The balance is adjusted upwards or downwards against general income development (income index).
- The cost of administration of national pension insurance is divided among the insured parties.

The system gives consideration to notional future growth so that pension development during retirement be relatively even and so that the step from salary to pension is not so dramatic. The social insurance office sends a pension statement containing a decision on pensionable income and pension rights to the insured party not later than 31 March each year.

Recalculation taking into account the survivor's bonus factor

Pension balances are adjusted upwards with survivor's bonuses. When survivor's bonuses are distributed among those of an economically active age (59 and younger), it is the actual amounts that are distributed. If a 45-year-old dies, his balance for income pension is simply divided among all insured 45-year-olds. As from the age of 60, the pension balance is instead adjusted upwards by an estimated survivor's bonus factor which is based on life expectancy statistics. The survivor's bonus factor for each cohort is set by the National Social Insurance Board and is the same for women and men.

Recalculation against the income index

As from 1961, the pension balance for income pensions has been retroactively adjusted upwards according to the income index.
The income index for 1999 was set at 100. 00. (See information about the income index on page 19).

Everyone receives an annual pension statement

The social insurance office sends pension information, advising of the decision on pensionable income and pension rights, to insured parties not later than 31 March each year. In addition, a forecast of the future size of the pension is enclosed.

Approximately 5.7 million statements were dispatched in 2003. The pension statement also reports changes in the balance compared with the previous year, both the balance for income pension and the balance on the premium pension account. The statement shows to what extent the change depends on recalculation against the income index, survivor's bonuses and administrative costs.

How the annual income pension is calculated

On retirement, the annualIncome pension is calculated by dividing the total pension balance by a figure, *the annutisation divisor*, which chiefly reflects the average remaining life expectancy in the respective annual cohort.

When average life expectancy increases, the annutisation divisor increases also. This simply means the longer people live, the lower annual pension they receive since the pension is paid over a greater number of years (on the other hand increasing average life expectancy should mean that people are capable of working longer).

Hence the annutisation divisors are different for different cohorts. After a cohort has reached 65 the annutisation divisor is not changed. The National Social Insurance Board establishes the annutisation divisor. Among other things, the divisor is based on the latest known life expectancy statistics over a five-year period.

Preliminary annutisation divisor before 65

The pension for those who draw pension before reaching 65 is calculated according to a *preliminary* annutisation divisor. The *final* annutisation divisor for a cohort is determined at the age of 65. National pension for those who retire early is recalculated when they reach 65, applying the final divisor.

Future growth is anticipated

Notional future growth is calculated into the annutisation divisor so that the step from salary to pension will not be too great. The growth norm ensures that the annutisation divisor will not be so high. The growth norm is 1.6 percentage points. Thus, the first year's pension will be higher than the pension balance divided by average life expectancy. In this way, the pensioner receives a share of future growth in advance. In the years ahead, the pension is adjusted upwards according to general income development, deducting the norm.

Development of the premium pension capital

Premium pension is earned in the same way as income pension. Unlike income pension, it is pre-funded, and the money is invested in funds. The premium pension is part of the national old-age pension system which means it is compulsory and, like income pension, payment of it is lifelong. Calculation follows actuarial principles and is gender neutral, the same for women and men.

The insurance operations of the premium pension system are managed by the Premium Pension Authority (PPM). It is accountable to both the National Social Insurance Board and the Financial Supervisory Authority. During the qualifying year, as contributions are paid in, the money is temporarily deposited in an account with the National Debt Office. The interest is credited to the pension-saver's pension rights. When
the premium pension rights for the year have been established (which can take place the year after the qualifying year at the earliest) the money is sent to the fund or funds the pension-saver has already selected in previous years. If it is the first time the pension-saver is to select funds, he/she chooses funds at the Premium Pension Authority, which ensures that the money is transferred to the funds selected.

Over the period 1995-1998, two per cent of pensionable income was allocated to the premium pension account. In 1999, when the system entered into force, the contribution increased to 2.5 per cent. Twentieths of the percentage rate were allocated to persons born in the period 1938-1953. The year 2000 was the first year personal fund managers were chosen and premium pension rights were invested for income years 1995-1998.

The pension-saver can change his/her choice of fund at any time. In the case of those who do not notify their choice of fund, the money is invested in the Premium Savings Fund which is managed by the Seventh National Swedish Pension Fund. Ordinary securities funds may manage premium pension money as also may foreign stock market companies entitled to operate in Sweden. Irrespective of selection or non-selection of fund manager, it is the individual that takes the financial risk. Thus, no guarantee can be given for the development of the value of premium pension money in the fund. Premium pension can be drawn from the age of 61 at the earliest. The full pension may be drawn or ¼, ½ or ¾ pension. It is also possible to suspend withdrawal and to change the proportion of pension drawn. The balance on the pension-saver's premium pension account may be invested in securities funds also during retirement. A traditional annuity insurance that guarantees lifelong payment of a fixed monthly amount may also be chosen during retirement. If the annuity alternative is chosen, the financial risk for the assets corresponding to the balance on the pension-saver's premium pension account is transferred to the Premium Pension Authority.

Survivor's protection during retirement

An application for survivor's pension is made by the pension-saver at the same time as his/her application for premium pension and means that the premium pension continues to be paid for life to the saver's surviving spouse or partner after the pension-saver's death. The pension will be lower if

survivor's protection is chosen since it is then calculated from the outset for two "lives", that is to say it does not end until the other spouse has died. An agreement on protection can be signed by persons who are married, are registered partners or who have previously been married or, alternatively have or have had children with their current partner.
The general rule is that survivor's protection starts to apply at the beginning of the first month for which premium pension is to be paid to the pension-saver.

Spouses/registered partners may transfer premium pension rights

Spouses who are covered by the national pension system are entitled to transfer pension rights earned in the premium pension system. The procedure for this is that the couple together notify the social insurance office not later than 31 January in the year the transfer is desired.

Fund managers in the premium pension system

The premium pension system is designed as a funded insurance system in which capital is invested in mutual funds administered by independent fund managers. The funded insurance model, among other things, means that the Premium Pension Authority (PPM) is a participant in the mutual funds in which money has been invested and it is hence PPM that buys and sells mutual fund units at unit trust companies. However, it is the pension-savers who decide which fund manager the money is to be deposited with and who bear the financial risk for the investment. Investments are made through PPM and the unit trust companies do not know who are their actual end customers.

Fund managers must follow certain rules.
1) notify PPM of their mutual funds for registration,
conclude an agreement with that authority on practical cooperation and on the price of their management services.
2) on request, supply information material to private individuals although the latter are not formally holders of mutual fund units.
3) undertake not to impose withdrawal charges.
4) undertake to report annually to PPM all costs charged to the fund, with a breakdown by different types of costs. This information is used in reports on funds, their focus and management results, etc., which PPM produces and supplies to pension-savers each year.

Guarantee pension

Everyone is entitled to a guarantee pension in the national pension system. However, the rules vary depending on whether a person was born before 1938 or in 1938 or later. The purpose of the guarantee pension is to safeguard a consumption level over and above housing costs. In addition, a housing supplement for pensioners is included in the basic protection system. (see the section on the housing supplement for pensioners on page 26).

The old pension rules cover persons born in 1937 or earlier – but they too are covered by the rules for the guarantee pension as from January 2003.

The basic protection consists of a guarantee pension adapted to a level corresponding to the net pension paid in December 2002. This means that the same tax rules apply to all pensioners when the first guarantee pension payments are made during 2003. The calculation basis for the guarantee pension is different for those born in 1938 or later to that for persons born before 1938, however the size of the pension will be about the same.

Several details apply to persons born in 1938 or later. The guarantee pension is paid as from the age of 65 at the earliest. The guarantee pension must be applied for. Moreover, the applicant must be resident in Sweden for the guarantee pension to be paid. An exception to this rule is residence in an EU/EEA country or countries with which Sweden has concluded an agreement. To obtain the full guarantee pension the requirement is 40 years' residence in Sweden between
the year in which the age of 25 is reached and the year 64 is reached.
The guarantee pension is reduced if a widow's pension, a foreign pension or an annuity is paid at the same time. There is no coordination with income from capital, occupational pensions, private pension insurances or attendance allowance.

- A single person who has no earnings-related pension at all or has an earnings-related pension of at most 1.26 price base amounts a year receives a guarantee pension so that the sum of the guarantee pension and the earnings-related pension adds up to 2.13 price base amounts a year. (The corresponding levels for married couples is 1.14 and 1.90 price base amounts respectively).
- A single person who is qualified for an earnings-related pension higher than 1.26 price base amounts obtains a top-up through the guarantee pension dependíng on how large the earnings-related pension is. For a single pensioner whose pension income is between 1.26 and 3.07 price base amounts, the guarantee pension will be 0.87 price base amounts plus 48 per cent of the difference between 1.26 price base amounts and his or her pension income.

A guarantee pension is not payable if the earnings-related pension amounts to 3.07 price base amounts or more. Married pensioners may also receive a guarantee pension in accordance with the same principles. The top-up amount provided by the guarantee pension ceases for married couples whose earned pension rights amount to at least 2.72 price base amounts.

Adaptation of pensions to Sweden's economic resources

In the national pension system, income pension rights are annually adjusted upwards in line with general income development. Pension payments follow income development with a deduction of the norm of 1.6 percentage units corresponding to the upward adjustment which the pensioners received in advance. This is called flexible indexation.

Principle of flexible indexation

Income index changes by	+0.50%	+1.60%	+2.50%
growth norm	-1.60%	-1.60%	-1.60%
=earnings-related pension and supplementary pension is recalculated by	-1.10%	0%	+0.90%

Flexible indexation means that pensions follow the income development of the working population with a deduction of 1.60 percentage points.

Flexible indexation is applied to all income pensions and supplementary pensions irrespective of when they were earned. This means that it also applies to pensions calculated according to the old rules.

With this link to income development, better alignment with the national economy is achieved. In this way pensions are linked to the general economic trend.

Income development index

An *income index* is used to measure general income development. The index figure is calculated in relation to the percentage change in the average income level in this country. *The index number measures the change in average income*. This number ensures that the value of pensions develops at the same pace as the income of the working population.
The income measure is defined as pensionable income for people in the age group 16-64 years, plus income over 8.07 income base amounts for people in that same age bracket. This sum is divided by the number of persons with the incomes in order to obtain an average income.

To compensate for the impact of cyclical fluctuations, change in income is calculated as the annual average for the last three years, minus price increases in the same period. Income is then increased again by the price increase in the last year.

Income base amount

In the same way as the consumer price index (CPI) is the basis for the price base amount, the income index is the basis for *the income base amount.* Just as in the case of the price base amount, the income base amount is established each year by the Government.
The first income base amount applied to the year 2001 and was the same as the higher price base amount. For the years after 2001, the income base amount will be recalculated according to the change in the income index.
The income base amount is chiefly the basis for

- upward adjustment of the qualifying ceiling,
- establishing levels for the so-called earned income requirement in connection with calculation of pension rights for childcare years, studies and compulsory service,
- calculating the standard amount that may be pensionable in connection with childcare years.

Automatic balancing of the PAYG system

The PAYG system has a fixed contribution rate of 16 per cent and indexation that follows average income development. This in combination with the fact that the annutisation divisor linked to average life expectancy makes the system considerably more stable than the old system. In the event of an unfavourable demographic and economic development, financial stability may be threatened, however, in that the pension system will not be able to fulfil its undertakings in the long term.

To achieve a totally stable system, mechanisms must exist for handling such situations. In the choice between raising the fixed contribution or adhering to the indexation, priority has been given to the fixed contribution which means that, instead, the indexation must be adjusted in such situations.

Departure from the indexation is regulated by so-called balancing. Automatic balancing is in the form of rules prescribing how the assets and debts of the PAYG system are to be calculated. The rules also deal with when and how departures from average income development indexation are to be made. The assets of the PAYG system consist of the value of income from contributions and the value of assets in the system's buffer funds. The value of the PAYG system's income from contributions is calculated as the pension liabilities the contributions could finance. The buffer funds are valued according to the prices the market paid at the time of evaluation for assets similar to those the funds manage.

Pension liability and balance figure

The *pension liability* of the PAYG system is made up of the pension balances and the pensions paid out. The PAYG system's liability includes both the income pensions as well as the supplementary pensions.
By dividing the system's assets by the pension liability a measure is obtained of the PAYG system's financial status, a so-called *balance figure*. If the balance figure is above one (1), assets are greater than liabilities. If the balance figure is below one (1), liabilities are greater than assets. If the balance figure should be allowed to remain below one, in the long term the buffer funds would be emptied and it would then not be possible to finance income pensions with a contribution of 16 per cent. In order to avoid this, the indexation of pensions and pension balances will be reduced if the balance figure falls below one. This is done by applying a balance index instead of an income index. The result is that the pensions and pension balances will be first recalculated annually using a lower index figure but later, in pace with improvements in the economic situation, will be restored to their original level.

What do we do with any surplus?

Under favourable demographic and economic conditions the funds may show a surplus. This surplus will in the first place be kept in the system and function as a buffer for future emergencies. In the long term the surplus may be larger than needed to manage the system's undertakings. Such surpluses will be distributed among the insured parties. There are no rules for this situation as yet but a method is currently being discussed.

Partial pension and flexible retirement age

Income pension and *premium pension* may be drawn as a full pension or as a ¼, ½ or ¾ pension.

Partial pension

The pensioner can choose to draw a partial instead of full pension (*reduction)* or to stop drawing pension (*cancellation).* The income pension the insured party forgoes is recalculated and added to the pension balance which is adjusted upwards by the income index and survivor's bonuses. There are no rules that prevent people from working and drawing a pension at the same time. Earned income confers additional pension rights. Thus, by working the pensioner increases his/her future annual pension in two ways. On the one hand, the pension rights calculated on earned income increase the pension balance and, on the other, pensions paid at a later date will be calculated applying a lower annutisation divisor.

Flexible retirement age

Income and premium pension can be drawn from the age of 61 at the earliest. The size of the annual pension increases the later the insured party chooses to retire. There is no rule specifying how small a pension may be in the case of early withdrawal. It is up to the individual who should then take into account that the pension will be lower and that a guarantee pension will not be payable until the age of 65. In this context, early withdrawal means before the age of 65.

Pension rights can be earned indefinitely. Under the Employment Protection Act, an employee is entitled to remain in his post until the age of 67. The limit could previously be negotiated downwards in collective agreements but this right ceased to apply after 2002.

Gradual introduction of the national pension system

The national pension system is being introduced gradually which means extensive rules are needed. The rules on qualifying years in the old national supplementary pension system (ATP) will be used for the last time when those born in 1953 reach the age of 64 in 2017.

Persons born in 1937 or earlier

Persons born before 1938 will receive supplementary pension under the old rules in accordance with the Income-Related Old-Age Pensions Act (LIP), with a few exceptions. These are, for example:

- In accordance with guidelines from the Swedish Riksdag, national basic pension, pension supplement and special basic income tax deduction were replaced by a guarantee pension on 1 January 2003.
- As from the turn of the year 2001/02, supplementary pension is also subject to flexible indexation in accordance with the present system instead of simply being adjusted upwards according to inflation as was previously the case.

Persons born in the period 1938-1953 (transitional generation)

The transitional generation will receive part of their pension according to the rules in the old system and part according to the new rules. The ratio depends on when a person was born, those born in 1953 will receive 19/20 from the reformed system and 1/20 from the old national supplementary pension system (ATP). For each year prior to 1953 a person was born, there is an adjustment in the number of twentieths, so that the oldest age group, born in 1938, will receive 4/20 according to the reformed system and 16/20 according to the ATP system.

Thus, both national supplementary pension points and pension rights according to the reformed pension system are calculated for people of the transitional generation until they retire.

Calculation of the ATP quotient in the old pension system does not take place until retirement. Pension rights in the reformed pension system on the other hand are calculated annually in ratios, since money has been deposited in the premium pension system as from 1995.

- For those born during the period 1938-1953 total pension rights are calculated as PAYG pension (income pension and supplementary pension) for the period up to 1995. This also applies to persons born in 1954 or later (income pension only). For the years 1995-1998 only money for pensionable income was allocated to the premium pension. Funds were subsequently allocated for the whole pension base, that is to say both pensionable income and pensionable amount.
- If an insured party of the transitional generation has pensionable income after the age of 64, pension entitlements are earned entirely according to the rules of the reformed old-age pension system.
- The qualifying ceiling was 7.5 higher price base amounts in 2000. It then became 7.5 income base amounts.
- Entitlement to the national supplementary pension, ATP (and some national basic pension) which the transitional generation earned up to and including 1994 is guaranteed. Should calculation of the ratio yield a lower total pension, this guarantee will apply, though from the age of 65 at the earliest.

Why did the national supplementary pension system need to be reformed?

The most essential reason for reforming the pension system was that costs for pensions had increased while economic growth was low. But there were also other reasons for altering the system. The National Supplementary Pension system, ATP, was unfair to people who had had low income growth and worked over a long period of time. Those who had worked a shorter period but had had rapid wage growth were favoured. So in spite of the fact that two people had paid the same contributions and had the same lifetime earnings, their pensions could be totally different.

Not linked to growth

In order that pensions in the ATP system should not lose value due to inflation, both earned pension rights and pension payments followed price development. Since real wages continually increased, the pension amounts were also continually raised – new pensioners always received higher ATP than the oldest pensioners. An unchanged contribution covered the cost increase as long as growth was adequate. Thus, the index pensions in the ATP system were predicated on good economic growth, that is to say at least 2 per cent a year on average. During the 1950s and 1960s GDP increased by over 3.7 per cent a year. Since 1975, however, the increase has been less than 2 per cent a year on average. Moreover, after 1975 there have been stronger economic fluctuations.

We live longer

The number of pensioners is increasing in relation to the working population. In 2000 there were 30 old-age pensioners to 100 members of the working population. 25 years later eleven more will need to be supported. Initially, the growing number of ATP pensioners was balanced by women's entry into the labour market, which gave the pension system increased revenue in the form of contributions. However, this has ceased to apply since the incidence of women and men in the labour market is now at the same level. Moreover, more and more people received higher and higher ATP while at the same time average life expectancy increased. The rising cost of pensions combined with low growth was the chief reason for devising a new pension system.

Reasons for the introduction of the national supplementary system, ATP

Prior to the introduction of the national basic pension system in 1947, for many Swedes old age was synonymous with poverty. Basic pension represented a considerable improvement but retirement still meant a major step downwards in terms of standard of living.
The national supplementary pension system, ATP, was introduced in 1960. The intention was to create a compulsory occupational retirement pension based on the loss-of-income principle. For the first time there was a system for all in which the pension was considered to be postponed wages for work performed and not a benefit.

A politically stable national pension system

The current national pension system was conceived in the early 1980s when it became clear that the old ATP system had certain deficiencies. In 1984 a committee was appointed to produce background material and present proposals for measures. The committee submitted an extensive report in 1990, containing background material and possible alternative solutions. Since decisions on the pension system must be informed by a very long-term perspective, an essential aim was that the future pension system should have as broad political support as possible.

In view of this, the working group on pensions was set up in 1991, which was made up of representatives of all the parties represented in the Riksdag at that time. Its task was to produce concrete proposals for a new national pension system. Five of the parties –the Social Democrats, the Moderate Party, the Liberal Party, the Centre Party and the Christian Democrats – negotiated a pension agreement in the working party and presented a report in early 1994.

Based on the agreement, the Government later presented a bill which the five parties jointly supported. The Riksdag adopted a decision in accordance with the bill and almost 85 per cent of the Riksdag thereby supported the future national pension system.

The details of the bill were not complete, nor did it contain any legal provisions. An implementation group representing the five parties was therefore appointed with instructions to produce detailed draft laws on the basis of the principles embodied in the bill. In addition to politicians from the five parties, the group also included a staff of officials, however the social partners were not represented.

During the period 1994-1997, a series of reports containing proposals for rules were submitted which were subsequently circulated for comment to organisations and agencies. In the light of these reports, the Government presented two bills in the spring of 1998, containing complete rules for a new national pension system. At this stage too, five of the seven parties represented in the Riksdag and over 80 per cent of the members of the Riksdag supported the reform. The underlying agreement also required that all parties should support every detail of the reform which meant that all must agree on any future amendments. The preconditions for a long-term politically stable national pension system were thereby assured.

A financially stable national pension system

The pension reform means liability for payment of the pensions has been changed and clarified. Basic security in the form of a guarantee pension and housing supplement for pensioners is financed entirely through the central government budget. The earnings-related parts such as income pension and premium pension are financed solely by contributions and returns from the buffer fund (the National Swedish Pension Funds). This also applies to the earnings-related supplementary pension that corresponds to ATP under the old rules.

To achieve a balance in the system between contributions and pensions, contributions are paid for all parts that bestow pension rights for income pension and premium pension, that is to say also for elements which are for purposes of distribution in the form of pensionable amounts for childcare years, compulsory service, studies and sickness or activity compensation. These contributions are financed by taxes via the central government budget.

The contributions are intended to be evenly divided between employers and employees but this has not yet been achieved and the employer's contribution is currently 10.21 per cent of wages while the employee pays seven per cent of his/her earnings. Regarding social insurance payments, the government pays the equivalent of the employer's contribution, a national old-age pension contribution. The remaining adjustment of the contributions is intended in principle to be neutral and for this reason will not affect the financial strength of the system. The wage earner's contribution is paid for income that confers pension rights, up to the ceiling which is 8.07 income base amounts. Employers' contributions are paid on all wages, for income in excess of the ceiling too. The part of the contribution that is under the ceiling is transferred to the pension system while the parts in excess of the ceiling go to the central government budget.

The PAYG system is a financially autonomous system that is completely separate from the government budget. It is financed solely by contributions and returns on the fund. The only withdrawals from the system are pensions paid and administrative costs. Due to the fact that the size of the pension is decided on the basis of average life expectancy and since both the outgoing earnings-related pension and accrued pension rights follow the wage trend, the system is in balance. Under certain circumstances, however, an imbalance between liabilities and assets may still occur in the PAYG system. This imbalance is corrected by the automatic balancing that is also the ultimate guarantee of a financially stable system in the long term.

The pension reform meant that payment liabilities for survivor's pension and disability pension were taken over by the government budget – the latter was replaced by sickness and activity compensation.

Who takes decisions in the national pension system?

The Tax Authority calculates and decides on pensionable income and the social insurance offices calculate and decide on pensionable amounts for the insured parties. Other agencies have an obligation to submit the necessary information to the social insurance offices. Decisions concerning premium pensions are taken by the Premium Pension Authority. If a private individual is not satisfied with the decisions of the social insurance offices or the Premium Pension Authority, he or she can request reconsideration or appeal the decision. The social insurance offices and the Premium Pension Authority are liable to reconsider a decision concerning pension rights and premium pension. If the complaint concerns pensionable income, the Tax Authority must also reconsider its calculation. The individual is entitled to request a reconsideration.

The Tax Authority, the social insurance offices and the Premium Pension Authority can reconsider their decisions on their own initiative. The county administrative court examines appeals but not until the social insurance office and Premium Pension Authority have reconsidered their decision. The National Social Insurance Board can also appeal decisions.

The next appellant court is the administrative court of appeal, however review dispensation is required for a hearing there. In the case of changes in, for example, assessed income and pensionable income, decisions on pension rights are automatically amended. If a self-employed person, for example, has not paid his/her contributions in time, taxes and employer's contributions are redebited and pension rights recalculated.

Ancillary benefits

There are some benefits that do not really come under the national pension system but are closely connected. These include housing allowance for pensioners, maintenance support for elderly persons, survivor's pension, and sickness and activity compensation.

Housing allowance for pensioners

Housing allowance for pensioners (BTP) is an essential part of the basic protection for pensioners with low pensions. BTP is a means-tested supplement to certain pension benefits dependent on both housing cost and income. BTP is at most 91 per cent of the housing cost up to SEK 4 500 a month. The rules for assessing the income that affects BTP relate to tax legislation. For those who have a high rent and low pension, a special housing allowance (SBTP) may also be granted for housing costs up to SEK 5 700 a month. To be entitled to BTP, a person must be claiming full old-age pension.

Decisions on BTP usually apply for twelve months, but may also refer to a different period if the social insurance office so decides. A new application is subsequently required to obtain continued BTP. At year 2002, about 460 000 persons received BTP, 325 000 of which were old-age pensioners.

Maintenance support for elderly persons

Maintenance support for elderly persons (ÄFS) is a new benefit which was introduced in January 2003. This benefit is addressed to persons over 65 who reside in Sweden and who have a small pension or no pension and who cannot manage their upkeep in any other way. In practice this primarily means that older immigrants who have lived a short time in Sweden receive ÄFS. People who have lived all their lives in Sweden may also in certain cases be eligible for ÄFS. It may, for example, apply to pensioners without national supplementary pension who have made early claims for old-age pension and hence live on a very low pension.

Forty years' residence in Sweden is required to obtain a full guarantee pension. If the period of residence is shorter, a certain proportion of the guarantee pension is paid. For example, four years of residence is equivalent to 4/40 guarantee pension. People in this category were previously referred to social services to receive their basic maintenance.

The purpose of ÄFS is, *inter alia*, to restore the social welfare allowance as an individual, means-tested allowance needed due to temporary financial problems. ÄFS is given to people who are 65 or older and resident in

Sweden. It guarantees a certain lowest economic standard of living. The size of the allowance depends on the income and housing costs of the person entitled to support. Rules on calculation and administration of this support largely follow the rules for the housing supplement for pensioners. The standard of living established as reasonable, after housing costs are paid, is 1.294 price base amounts per year for those who are unmarried and 1.084 price base amounts for married persons. Reasonable housing costs may amount at most to SEK 5 700 a month. Both the basic level and compensation for housing costs are fully means-tested minimum levels that are reduced in principle against all other income.

Survivor’s pension

When the present national pension system was introduced, linked pension benefits must also be adjusted, as basic pension and the special tax rules were abolished. As of January 2003 some new rules therefore apply.

Survivor’s pension based on deaths in 2003 or later may be paid as child’s pension, adaptation pension/extended adaptation pension and widow’s pension. To supplement or replace the above-mentioned benefits, a guarantee pension may be paid to adult survivors and survivor’s protection to children. All these pensions are earnings-related except the guarantee pension and survivor’s protection which are basic protection.

The purpose of the survivor’s pension is to give economic support to survivors to enable them to adapt to their new economic situation in the time immediately following a death in the family. Child’s pension is paid up to and including the month the child reaches 18. In certain cases relating to studies, the child’s pension may be extended, however up to and including June in the year the child reaches 20 at most. A surviving woman or man under the age of 65 and who was permanently living with his/her spouse at the time of death receives an adjustment pension if, at the time of the death, the survivor was permanently living with children under 18, or had continually lived with the deceased for at least five years up to the time of death. Persons are regarded as married who at the time of the death of the deceased were permanently cohabiting with him/her, if they had previously been married to each other or have or have had children by him/her or were expecting a child by him at the time of death. Women born in 1944 or earlier may on certain conditions receive a widow’s pension if married to the deceased at the end of 1989. Women born in 1945 or later may on certain conditions receive a widow’s pension if they were married to the deceased at the end of 1989 and at that time fulfilled the conditions for entitlement to widow’s pension. Furthermore, they must have been married up to the time of death and at that time also fulfil the conditions for entitlement to widow’s pension.

Sickness compensation and activity compensation

Background

In connection with the introduction of the present national pension system, the national basic pension and pension supplement were abolished as well as the special tax rules for pensioners. Hence the reform also affected the disability pension system which was adapted to the new conditions. In connection with this adaptation the old disability pension system was changed. The most essential change was that disability pension was separated from the old-age pension system and incorporated into the national health insurance system. Disability pension was abolished as a concept and replaced by sickness compensation and activity compensation.

Sickness compensation

As mentioned above, sickness compensation is not included in the old-age pension system but in the national health insurance system. It is paid to insured parties in the age group 30-64 whose work capacity is reduced at least 25 per cent due to illness or other impairment of their physical or mental performance where the impairment is considered permanent or may be assumed will last for at least a year.

The earnings-related sickness compensation is calculated on the basis of a so-called assumed future income. The assumed future income is calculated as an average of the three highest gross annual incomes earned by the insured party over a given period (framework period) immediately preceding the year of the insurance application.

Sickness compensation is supplemented by basic protection, guaranteed compensation, for those who had a low income or no income during the period preceding the insurance application. The guaranteed compensation is paid to persons residing in Sweden who are insured for sickness compensation in the form of guaranteed compensation both at the time of the insurance application and later. Guaranteed compensation is only paid to those who have been credited with an insurance period of at least 3 years. To be entitled to unreduced guaranteed compensation, the insurance period must be at least 40 years. It is reduced by 1/40 for each year short of this number. The paid earnings-related sickness compensation is pensionable income for old-age pension. However, guaranteed compensation does not confer old-age pension rights. Those whose disability pension has been converted to sickness compensation receive old-age pension rights equivalent to those received in newly granted sickness compensation.

Activity compensation

Activity compensation, which is compensation under the health insurance system, is paid to insured parties in the 19-29 age group and may be paid for three years at a time at most during this period. Sickness compensation is not applicable until after this period. Depending on the extent of reduced work capacity, full, ¾, ½ or ¼ activity compensation is paid. Activity compensation is calculated on the basis of the insured party's income during the three years preceding the year the right to compensation occurs in accordance with special rules. If the insured party has a low income or no income in the years preceding the year of entitlement to compensation, he or she receives activity compensation in the form of a guaranteed compensation.
The aim of activity compensation is to stimulate young people to take part in activities without their financial security being jeopardised. An essential precondition for stimulating young people to be active is that the individual

him/herself may as far as possible decide what he or she wants to do. In this connection, the social insurance office should assist in and supervise the activities in which an insured party is participating.

An insured party entitled to sickness or activity compensation may leave it dormant during the whole period of entitlement if he or she tests gainful employment.