

KOMMENTAREN

The pension reform debate

by KG Scherman

Over the last decade an intense debate has been going on about pension reform. Following political problems in reforming traditional DB systems, but also for a variety of other reasons, new models have been introduced and intensely advocated by their respective proponents. After a reform in Chile in the early 1980s, the “Chilean model”, a funded system based upon mandatory individual accounts, became the centre of the debate. Now, the recent reform in Sweden is subject to much comment, and the “Swedish model” is being recommended by the World Bank, the European Commission and numerous finance ministries. Swedes are saying: “With so much international praise, it must be a good reform we have implemented”.

We must sort out what this new “Swedish model” really is. After all, the Swedish reform is a complete overhaul of most of the basic features of the former public pension system with a switch from the traditionally accepted solidarity concept to what the Swedish Government calls “actuarial solidarity” which is the guiding principle behind the reform. What do the proponents of the Swedish model really mean when they refer to it? There is a wide range of possible elements to consider.

From a pension system point of view, there are the following features:

- The introduction of a funded pension component alongside the PAYG part;
- A completely changed PAYG scheme, ending up in the “notional defined contribution” (NDC) model;
- A successive phasing out of the minimum pension in the face of economic growth.

From the point of view of outcomes, the following are particularly relevant:

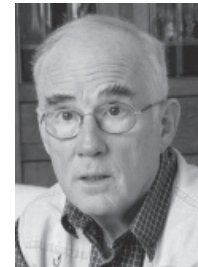
- Life-time earnings as the basis for the level of retirement pension;
- Abolishing the “normal pension age”;
- Taking increasing life expectancy into account in the calculation of pensions, thereby steadily raising the age when a person can retire with an adequate pension.

From the point of view of pension politics, yet other features come to the fore:

- There was a broad political consensus behind a reform that effectively reduces pensions and pension expenditure;
- There was no public opposition despite reductions in future pensions.
- Sweden’s reputation as an advanced welfare state makes it useful for politicians elsewhere to refer to their reform proposals as following the Swedish model.

Given the above aspects of the Swedish reform, it is clear why it is claimed that many reforms follow the Swedish model. Indeed, this can be claimed for every successful reform which reduces pension expenditure. Second, it can be claimed for every reform that, in

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the face of raising life expectancy, increases retirement ages and/or accomplishes a corresponding result by reducing benefits drawn at a certain age (such as has happened in Finland and is proposed in Germany and Norway). Third, such a resemblance can be claimed following the introduction of a funded component in the public pension arrangements (for example, in Poland, Hungary and in the voluntary scheme in Germany). Finally, it can be claimed whenever an NDC approach is adopted (such as in Latvia, Poland and Italy)

Clearly there is a need to know what a reference to “the Swedish model” really means. To which of all the features enumerated above does a reference to “the Swedish model” refer? This is needed in order to avoid confusion that otherwise might arise from an association of various features of the new Swedish model with what Swedish welfare arrangements have traditionally stood for, but which does not apply to this pension model. And such a clarification it is needed for Swedes better to understand the reasons for the international praise of our reform.

It is also worth phrasing a question based on a concern shared by many international experts, when considering the distribution of risks in different pension models: Is there any truth to the allegation that in choosing among pension models, the NDC model is popular, not necessarily because it is a good system, but because it is not possible for the general public to properly understand the implications of the system, and hence it can be introduced without public opposition?

I am happy to note that many outstanding international experts have accepted the invitation to come forward and help to investigate these matters. In this issue, Bernard Casey of the London School of Economics and the Pensions Institute, Cass Business School, brings to us his views. He writes about the need to take a whole range of policy areas into account when making a full assessment of a

pension system, discusses terms such as security, equity, effectiveness and solidarity, provides a framework for assessing how vulnerable pensions systems might be, and analyses the reform processes, including the why and how governments might try to avoid political responsibility for making unpopular change.

In subsequent issues we will have the opportunity to read articles addressing topics including:

- the economics of public pensions and their social objectives, and how well the NDC model can create an appropriate balance between social goals and financial constraints;
- a need for a closer coordination of European pension systems and for them to adopt a more actuarial approach - an approach where a NDC system would be a good alternative;
- retirement ages and the consequences for individual retirement decisions and the national economy of an actuarial approach to retirement age, as well as the political implications of such an approach;
- a German perspective on the Swedish pension reform;
- whether the NDC model is really new or a variation of the traditional DB model;
- an overview of the pension debate where the NDC model is put into perspective along with other approaches to public pension reform.

From this series of articles, and the preceding articles in the series, beginning with Messrs Hagberg and Wohlner in no. 2/2002, and followed by articles by Messrs Settergren, Könberg and Scherman, it is planned to further clarify matters and to make Swedes aware what the Swedish pension reform really is all about. As a part of this information dissemination, an international seminar may be held during 2005, and other events will also be held.