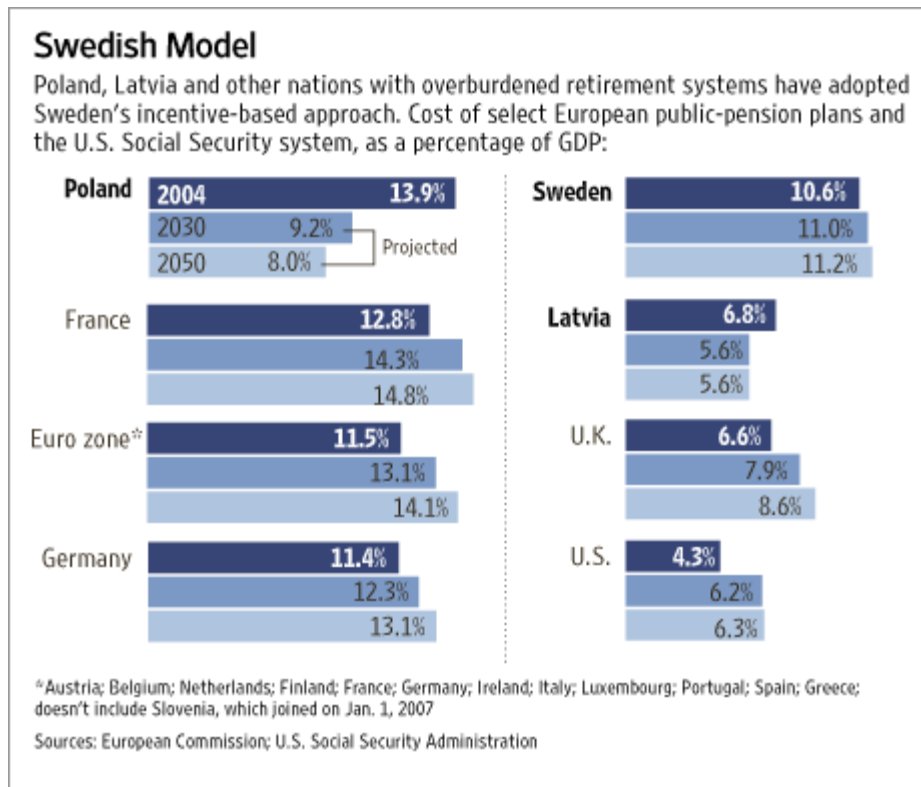


Sweden's Pension Antidote Finds a Global Audience

Flexible Payout System Puts Onus on Individual; A Private-Account Rule
By JOELLEN PERRY. WSJ, March 5, 2007; Page A6

As aging populations and shaky public finances make overhauling pension systems a global priority, an initiative implemented nearly a decade ago in Sweden is looking like the pension world's next big thing. By pegging public pensions to individual earnings and overall life-expectancy rates, Sweden has given its citizens incentives to be more productive and retire later - and sidestepped the political paralysis that has stymied change elsewhere.



Some Eastern European nations have already ditched their struggling post-Communist systems and gone Swedish. Steps taken in countries as diverse as Brazil and Russia boast some Swedish elements. A World Bank book based on the Swedish model has been translated into Chinese. And next month, Egypt's government will review plans to chuck the country's failing system for a Swedish version. "There's no magic solution to the pension problem. But governments world-wide are looking at" Sweden, says Kent Weaver, political-science professor at Georgetown University in Washington. "It's starting to be seen as the best among what are now seen to be imperfect options."

Sweden's plan -- designed in part by an American expatriate -- is conventional in that current workers' contributions fund current retirees' benefits, much as the Social Security system does in the U.S. But calculating payouts according to salaries and aging projections gives it the flexibility to accommodate revenue and population shifts. If the economy does poorly, the thinking goes, future pension payments will go down. And the longer people in a particular age group are projected to live, the smaller their pension payouts will be. Or at least that is the theory. The changeover was made in 1999, so not enough time has elapsed to thoroughly test it. In fact, Sweden's economy has done so well since 2003 -- when benefits started being calculated in part under the new rules -- that pensioners have received more than they would have under the old structure. The downside is that if and when growth falters, retirees will get less. "It hasn't

happened yet, but it will," says Ole Settergren, director of the pensions department at Sweden's Social Insurance Agency.

That approach is a break from the typical pay-as-you-go system, which defines a guaranteed benefit in advance but often saddles the state with underfunded obligations -- particularly when times are bad. Sweden's system "is not a good system if you want to subsidize leisure," says Edward Palmer, a professor of social-insurance economics at Stockholm's Uppsala University and a Colorado native who helped design the plan. It can be a good system, however, for politicians wary of revamping pensions, because it allows them to defer to a formula rather than promoting the unpopular options of later retirement and smaller benefits. "The political discussions behind [things like] increasing the retirement age are much more cumbersome than if it just happens mathematically," says Robert Holzmann, senior director of the World Bank's Social Protection unit in Washington. Skeptics point out, however, that politicians still could eventually be pressured to change the system if benefits get too skimpy.

Sweden's plan has other critics. It is a tough sell elsewhere in Western Europe, where many see generous pensions as a right. Other critics include the International Labor Organization, which holds that earnings-related pensions should guarantee 40% of a person's prior average earnings. Swedes, unlike the majority of Western Europeans, get no such assurance. The system also preserves existing income inequality: Workers who earn more get more when they retire. In the U.S., Social Security tracks what people pay through the bulk of their careers, but it reroutes contributions from wealthier citizens to prop up poorer workers' pensions. The bottom line of the Swedish model: Most people will have to work harder to reap the kinds of pensions their grandparents could take for granted. "It puts the cost of aging onto the individual, rather than onto society," says Sarah Brooks, an Ohio State University political-science professor who has studied the plan. Last February, the World Bank endorsed the Swedish plan as a possible antidote to pension woes world-wide. Economists at the European Central Bank followed up last fall, highlighting Sweden's approach for the 13-nation euro zone, where one-third of the population will be older than 64 by 2050.

In countries with strapped budgets, the Swedish plan's attraction is its premise that something is better than nothing -- in other words, stingier payouts help ensure the system doesn't collapse. That was crucial to persuading unions in Egypt to endorse that country's new Swedish-inspired pension plan. "They know [the old plan] is generous, but they also know it will not be there," says David Robalino, a World Bank economist who has been working in Egypt. In Poland, where a public-relations campaign helped ensure an enthusiastic transition to a Swedish-style system in 1999, the fiscal benefits are already clear. A recent European Union report said that, despite having some of the worst demographics on the Continent, "the long-term budgetary impact of aging in Poland is the lowest in the EU." Like Sweden, Poland mandated that a slice of pension contributions go into private accounts similar to a 401(k), where the money is invested in mutual funds. Swedes contribute 18.5% of their salaries to the pension system; only a small portion of that -- 2.5 percentage points -- is held in individual accounts. Poles contribute a total of 19.52% of their gross salaries to the system, with 7.3 percentage points going into private accounts. The concept of individual accounts has been key to selling the plan to Swedes. Sweden sends its workers statements -- mailed annually in bright orange envelopes -- showing what they have put into their pension and what they would get at retirement. The money isn't really there for them (it is being paid to current retirees). But advocates say seeing it expressed as an individual account should have the psychological effect of encouraging people to work longer to win bigger benefits.

It may be working. Sweden's official retirement age is 61 years old. Since the change took effect, the average age at which Swedes retire has risen to 63. Even partially adopting the Swedish plan can have benefits. Brazil doesn't send its citizens annual statements, and there is no private-account component. But individual-contribution and life-expectancy rates have been used to calculate private-sector pension payouts since 1999. Brazilian officials made the change after studying the Swedish model, and they have seen costs fall since. Perhaps the Swedish plan's biggest drawback is that it remains relatively untested. The first wave of retirees who get all their

benefits based on the new model won't hit for another few years, and the country hasn't suffered a major economic slowdown since adopting the plan. "It certainly has the virtue of spelling out, in anticipation, what people have agreed should happen," says Olivia Mitchell, director of the Pension Research Council at the University of Pennsylvania's Wharton School. "But that doesn't necessarily mean that it will."

SCANDINAVIAN MODERN

- The Issue: Sweden's decade-old pension system may offer a model for other countries coping with aging populations.
- The Background: Pension payouts are tied to salaries, life-expectancy rates and the health of the economy.
- The Bottom Line: Swedes are retiring later now. The formula averts some political friction.

Write to Joellen Perry at joellen.perry@wsj.com