

PRIVATE ACCOUNTS IN SWEDEN

In 2000, Sweden established mandatory private accounts covering all employed and self-employed persons as part of its retirement income system.

The Swedish private accounts are add-ons to a generous social security program. The Swedish system requires a contribution rate of 2.5 percent of wages as an add-on to a social security system that requires a contribution of 16 percent—a total contribution rate of 18.5 percent.

The Swedish private accounts are operating in a country with very low poverty. While private accounts may be especially risky for people with low incomes, the poverty rate for Sweden's elderly was 0.8 percent in 1995 (Smeeding 2001).

Private accounts are risky. Most workers have lost money on their private accounts. Participants bear investment market risk. The contributions of participants not choosing a fund for their investments are invested in a default fund. The total return for the default fund was -10.6 percent in 2001 and -26.7 percent in 2002, and most other funds lost money as well (Sjunde Ap-fonden 2003).

Most Swedish workers “choose” the default fund. Workers can choose from among 650 funds offered by 75 financial institutions. The contributions of those who fail to make a choice are placed in a government-managed default fund. Over 90 percent of new participants, most of whom are young people entering the labor market, do not choose a fund on their own (Sundén 2004). This high rate

may reflect in part that many observers recommend participants to “choose” the default fund.

The government is involved in making investment decisions. Because of social policy considerations, the government prevents the default fund from investing in some well-known companies, including Coca-Cola, Exxon Mobil Corp., Liz Claiborne, Inc., and Sears Roebuck & Co. (Sjunde Ap-fonden 2003).

There is a long lag in crediting pension contributions to private accounts. To save on administrative costs, contributions are credited to accounts once a year after the government has received income tax information. It takes on average 18 months from the beginning of the tax year for workers' contributions to be credited to their accounts (Sundén 2004).

Private accounts have led to more government bureaucracy. Rather than reducing the role of the government in providing retirement income, the system has increased the government bureaucracy. The system is administered by a new government agency—the PPM (Premipensionsmyndigheten in Swedish), which acts as a clearinghouse and record keeper for the funded private account system. This new agency was needed because the private account system includes a broad range of new activities that would have been difficult to undertake within the traditional functions of the social security agency.

Private accounts facilitate phased retirement. Workers can claim full or

partial (one-quarter, one half or three-quarters) benefits. They can continue working while they draw benefits, in which case they would continue contributing to the system.

The system does not provide inflation-indexed benefits. Unlike the U.S. Social Security program, the mandatory private accounts do not provide inflation-indexed benefits.

The system provides a guaranteed minimum rate of return for annuity conversions. Starting from the date when benefits are first claimed, the account balance must be paid out as an annuity. In order to reduce interest rate risk, the Swedish government guarantees a minimum rate of return of 2.7 percent for converting account balances to annuities.

The system does not provide automatic survivor's benefits. Survivor's benefits are voluntary. In contrast to the U.S. Social Security system, where provision of spouse and survivor's benefits does not reduce the benefits paid to the worker, in Sweden survivor's benefits are "purchased" at the cost of a reduction in the benefit received while both partners are alive.

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