

OSLOMET

# The Norwegian pension reform miracle and the trilemma of minimum protection in old age

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# Outline

- The political process
- The content of the reform
- Reform outcomes – so far and projected for the future
- The trilemma of minimum protection in old age

# The political process

# Motivation

- General concerns about the systems' financial sustainability
- Particular concerns about early retirement and falling effective retirement age in the 1990s
- Inspiration from the path-breaking Swedish NDC-reform

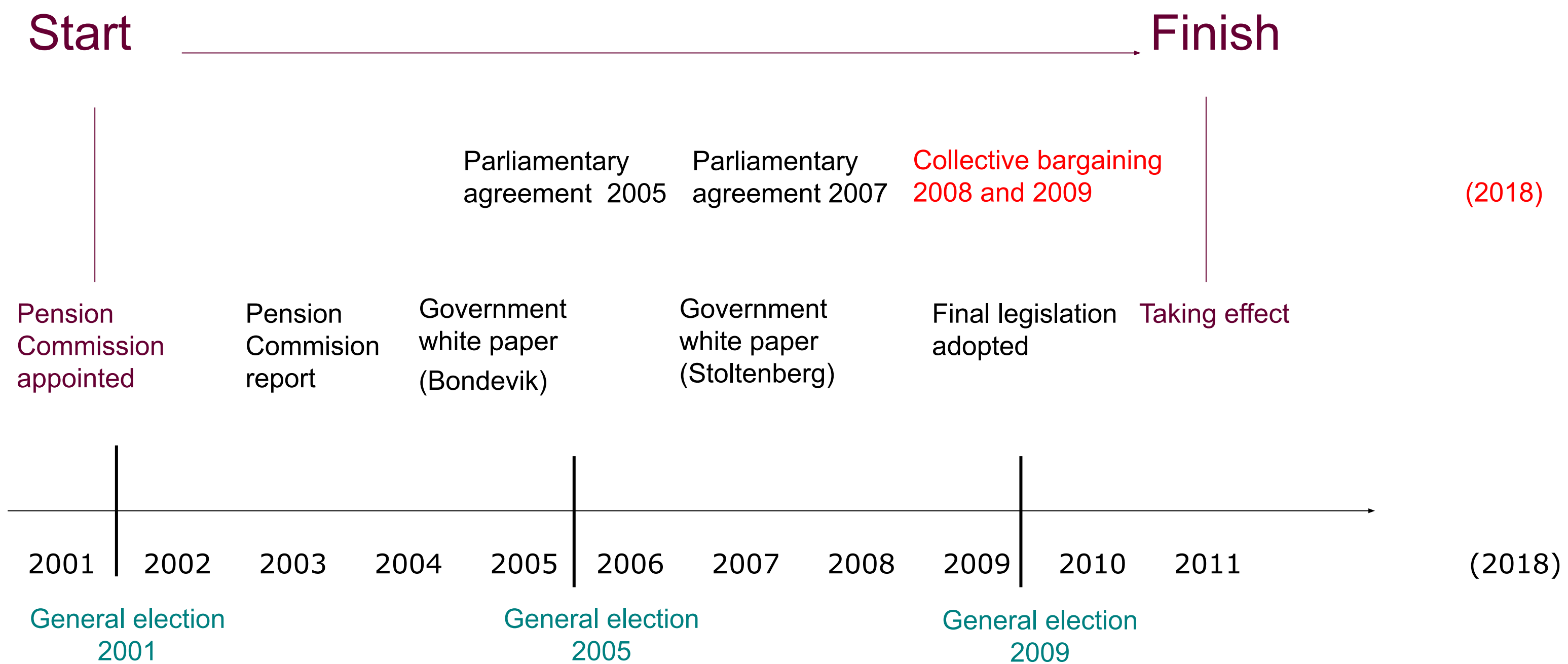
# Few immediate reform pressures

- Comparatively high and stable employment rates age 55+
- Rapid build-up of “Petroleum fund” aka “State Pension Fund Global”
- No acute economic crisis

# Old age pension expenditure

		Projection		
	2000	2050	Difference	
Norway*	4.5	14.8	10.3	
Sweden	9.2	10.8	1.6	
Denmark	6.1	8.8	2.7	
Germany	11.8	16.8	5	
Italy	14.2	13.9	-0.3	
France	12.1	16.0	3.9	
Spain	9.4	17.4	8	
UK	4.3	3.6	-0.7	
US	4.4	6.2	1.8	
OECD average	7.4	10.8	3.4	

# Ten years underway (seventeen)



# A structural reform

- Proportional (NDC) income pension+guarantee pension  
*a closer and more transparent link between earnings and pension benefits*
- Flexible retirement from age 62 on actuarially neutral terms  
*no subsidies to voluntary early retirement, each worker pays for his/her choice of retirement age*
- Longevity adjustment of benefits  
*the costs of increasing longevity to be carried by pensioners*



# The reform strategy

## Economic sustainability through:

- Reduced expenditure
  - longevity adjustment Estimated effect in 2050  
-18%
  - less than full wage indexation of pension benefits -7.5%
- Higher employment and labour supply
  - a closer link between lifetime earnings and pension wealth
  - flexible retirement on actuarially neutral terms

# The Norwegian pension reform of 2011

## Why a miracle?

A structural pension reform carried through the political system in a fairly open process and pluralistic process

- The preparation period spanned general elections where voters could have voted for parties opposing the reform
- Organized labour was – in the end - brought on board

# But not without the use of Machiavellian tactics

- *Diffusion* of political responsibility
  - Attempt to build a “policy cartel” in 2001, sidestepping organized labour
- *Compensation* (side-payments) to powerful stakeholders
  - The consent of organized labour was eventually bought by continued state subsidies to a negotiated pension schemes only covering organized workers
- *Obfuscation* of the issues involved
  - The severity of the longevity adjustment was not clearly communicated to the voters
  - The promise of a liquidity boost resulting from the possibility to combine continued working after age 62 with old age pension take-up

Paul Pierson (1996)

# The content of the reform

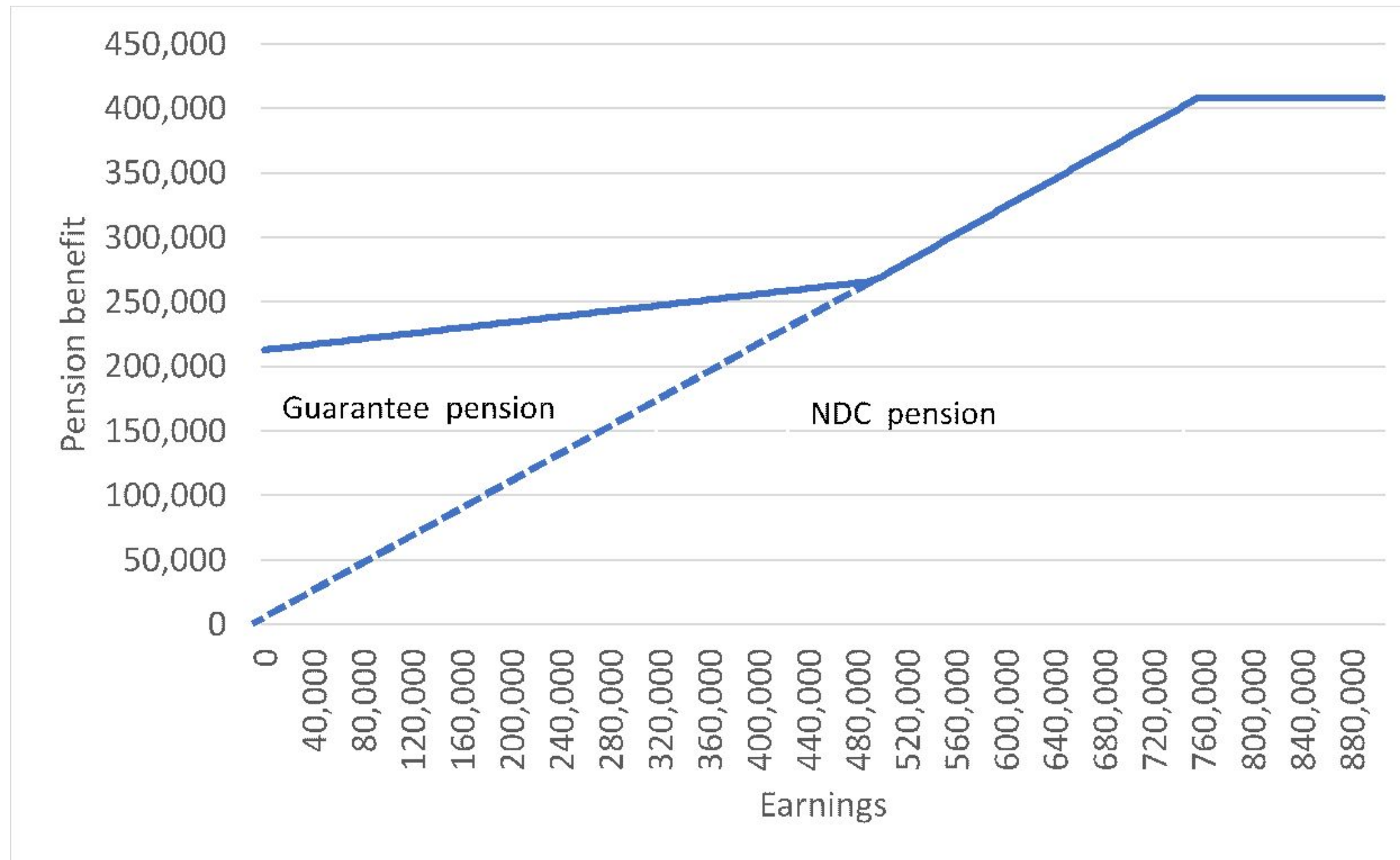
## A notional (**un-**)defined contribution system

- Pension accrual in notional accounts: 18.1% annual earnings (ceiling at 1.3 times average wage)
  - Accounts are indexed with wages
  - Accumulated accounts are transformed to an annuity upon retirement based on the cohort's remaining life-expectancy
- 
- New system fully integrated with the state budget and financed out of general taxation
  - No pension contribution is specified
    - A pay-roll tax of 14.1% and a social security contribution of 7.8% are basically taxes
  - No hard budget line on future pension expenditure

# Flanked with generous minimum protecton

- A guarantee pension at about 50% of the net average wage
- Tested against NDC benefits with an 80% taper
- The guarantee pension to be indexed with wages but modified by the longevity adjustment – not so generous in the long run

# Benefit profile of the National Insurance system



# Flanked with two layers of occupational pension schemes

## Privat sector:

**First layer:** fully funded company specific schemes in private sector, made mandatory in 2006. Contribution rates between 0 and 25.1 % of annual wage. Strongly regressive benefit profiles. Pure savings schemes with a minimum 10 year payment period (no sharing of longevity risks)

**Second layer:** negotiated scheme between the peak organisations (AFP). Proportional/progressive benefit profile, pay-as-you-go financing, unisex life-long annuity, coverage: about half of the private sector



# Flanked with two layers of occupational pension schemes

## Public sector:

**First layer:** Negotiated with public sector unions. Currently under transformation from DB to a kind of NDC. Prefunded in the municipal sector, pay-as-you-go financing in the state sector. Contribution rates between 5.7% and 23.8 % of annual wage. Regressive benefit profile. 100 coverage among public sector employees. Unisex lifelong annuities

**Second layer:** negotiated scheme with public sector unions (Public sector AFP). Proportional/progressive benefit profile, pay-as-you-go financing, life-long annuity, coverage: all public sector employees

# The role of the State «Pension» Fund

The fund's market value

**11 568 821 998 185** NOK

We work to safeguard and build  
financial wealth for future generations

- Appr. 3.3 times annual GDP
- The returns of the fund (3% p.a.) are transferred to the state budget
- Allows a permanent government budget deficit of 10 % of the current GDP

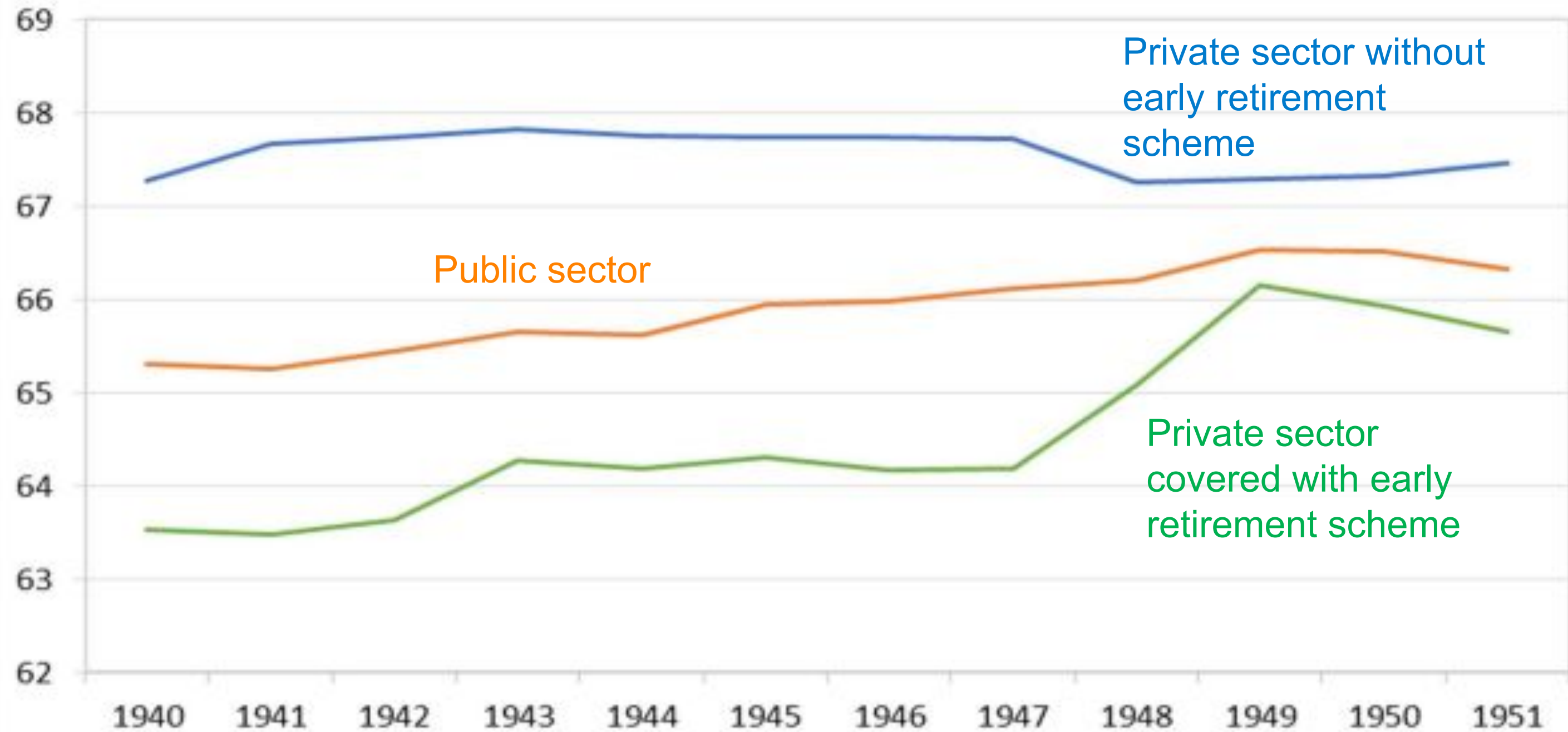


# Reform outcomes

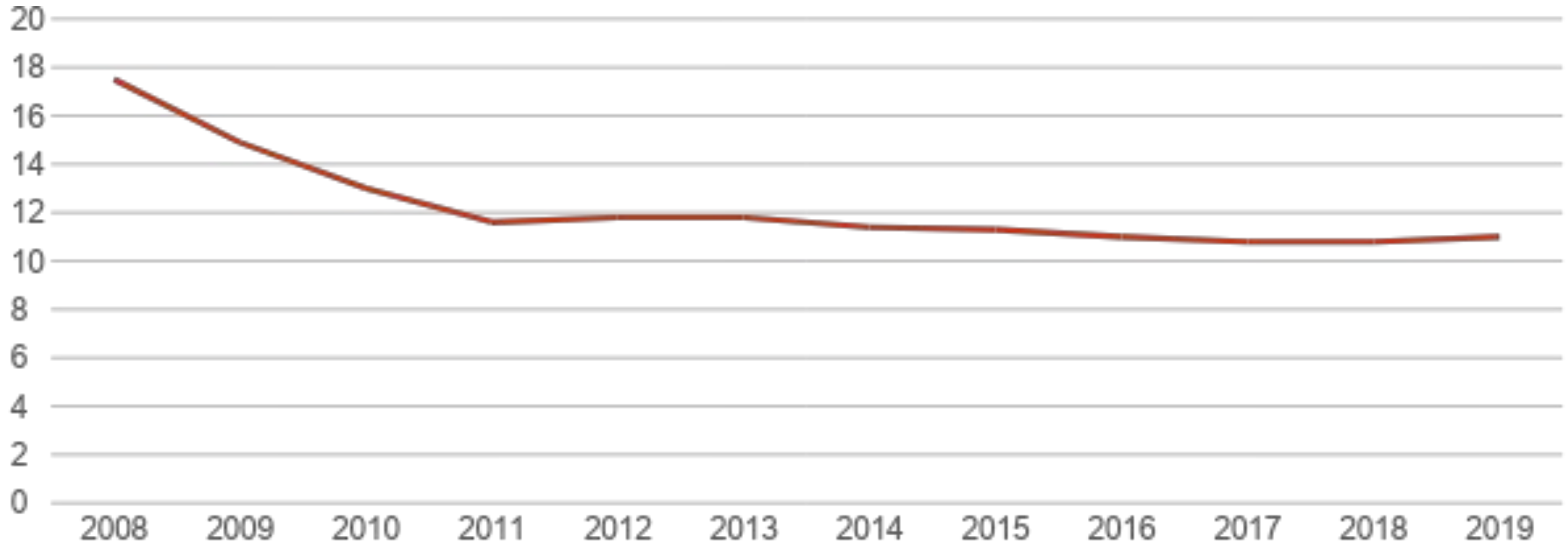
## Behavioural effects so far

- Higher effective retirement ages – in particular among those groups for whom the incentives for early retirement were changed most dramatically
- Lower age of drawing benefits. A majority – particularly among males – use the flexibility offered in the new system to take-out benefits from age 62 while continuing working.

# Median retirement age



# At-risk-of-poverty rate age 67+, in %



# Distributive effects of the reformed system: Not dramatically different from the old National Insurance system

The distribution of old age pensions, Projections for 2050

	Gini coefficient	Gender gap (female/male)
Present system	0.111	0.90
Reformed system	0.146	0.86

## **The distributive profile of the combined system less favorable**

- The National Insurance system is fairly progressive, thanks to the generous minimum protection and the ceiling on pension accrual
- The supplementary, occupational pension systems are strongly regressive
- Relative income poverty among old age pensioners is likely to increase



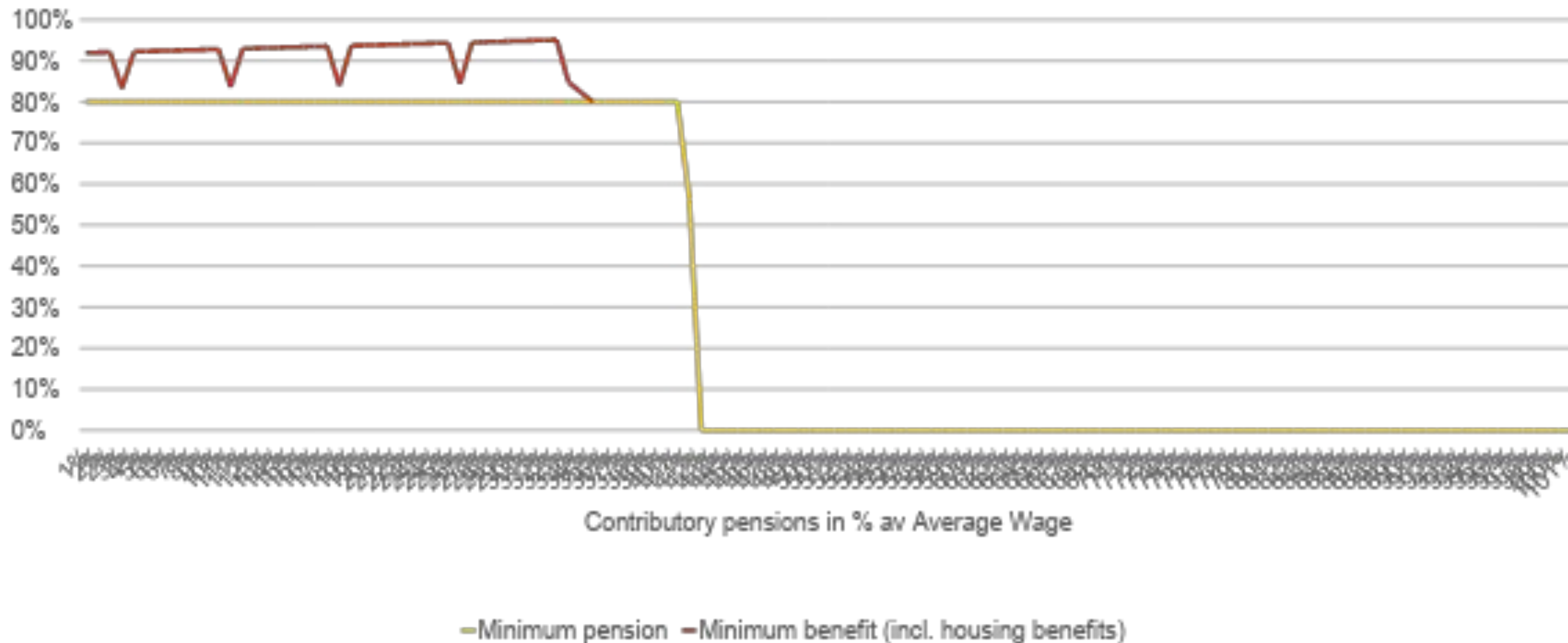
# The trilemma of minimum protection in old age

# The trilemma of minimum protection in old age

Impossible to simultaneously achieve




- A high level of minimum protection
- Keeping expenditure low
- Making work pay (maintaining a strong link between previous earnings and pension benefits)

# Implicit marginal tax-rate on contributory pensions






# The trilemma of minimum protection in old age

## The Norwegian solution

- A high level of minimum protection 
- Keeping expenditure low 
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