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OPINIONCOMMENTARY Follow

How Sweden Saved Social Security

Centrist parties of the left and right came together 30 years ago to save pensions from insolvency.

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The Swedish Parliament in Stockholm, April 16, 2020.

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Stockholm

‘There are few issues on which Sweden and the United States are not in perfect sync,” then-Vice President Joe Biden said here in 2016. Here’s one: Social Security. President Biden refuses to consider any reforms, and so do many Republicans. But that won’t save the program; it’ll doom it. In a little over a decade, the trust fund will be exhausted.

Sweden faced the same problem in the early 1990s. The old pay-as-you-go pension system had promised too much. With fewer births and longer lives, projections showed the system would be insolvent a decade later. As Mr. Biden has said in another context, Sweden has “an ethic of decency.” Its politicians chose not to deceive the voters. The center-left Social Democrats acknowledged that the system “would not withstand the stresses that can be foreseen.”

In 1994 the Social Democrats agreed with the four center-right parties to create an entirely new system based on the principle that pensions should correspond to what the beneficiary pays into the system—a system in which the contribution, not the benefits, is defined.

The reforms were designed to make it impossible to run a deficit and pass the costs to future generations. Crucially, the agreement introduced a balancing mechanism nicknamed “the brake.” When the economy is doing worse than expected, pension benefits are automatically reduced, and when the economy picks up again, the brake is released.

Sweden introduced partial privatization of the kind the American left derides as a Republican plot to gamble our money away on the stock market. The Swedish government withholds roughly 2.3% of wages and puts it into individual pension accounts. Workers are allowed to choose up to five different funds in which to invest this money, according to their own risk preference, and can change them at any time free.

Commentators claim partial privatization would mean that pensions could be lost in a financial crash. That ignores that the money isn’t all invested or withdrawn at the same time, meaning that the performance in a single year isn’t crucial. The returns from the normal income pension is around 2% per year, but from the private accounts the average Swede has made an impressive average return of roughly 10% a year since its inception in 1995, despite the dot-com crash, the financial crisis and the pandemic.

Swedish social security isn’t perfect and doesn’t satisfy everyone, but it has the obvious advantage that it actually works and is sustainable in the long run. Far from being a cautionary tale, Sweden’s pension system was recently described as the world’s best by the insurance group Allianz, based on a combination of sustainability and adequacy.

The Swedish far left and far right never accepted the reform and have demanded and sometimes won higher payouts. But most of the system remains intact after almost 30 years. No doubt, part of the explanation is that Swedish politicians prepared their citizens with an adult conversation about costs, benefits and what was possible, instead of merely rehearsing slogans and ignoring the inevitable crash.

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