

Social Security: Lessons from Sweden and the Netherlands

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Main points

- ◆ How should we require people to save?
- ◆ Resiliency to economic/demographic change
- ◆ Portfolio allocation
- ◆ Prediction risk
- ◆ Benefit targeting
- ◆ Disability

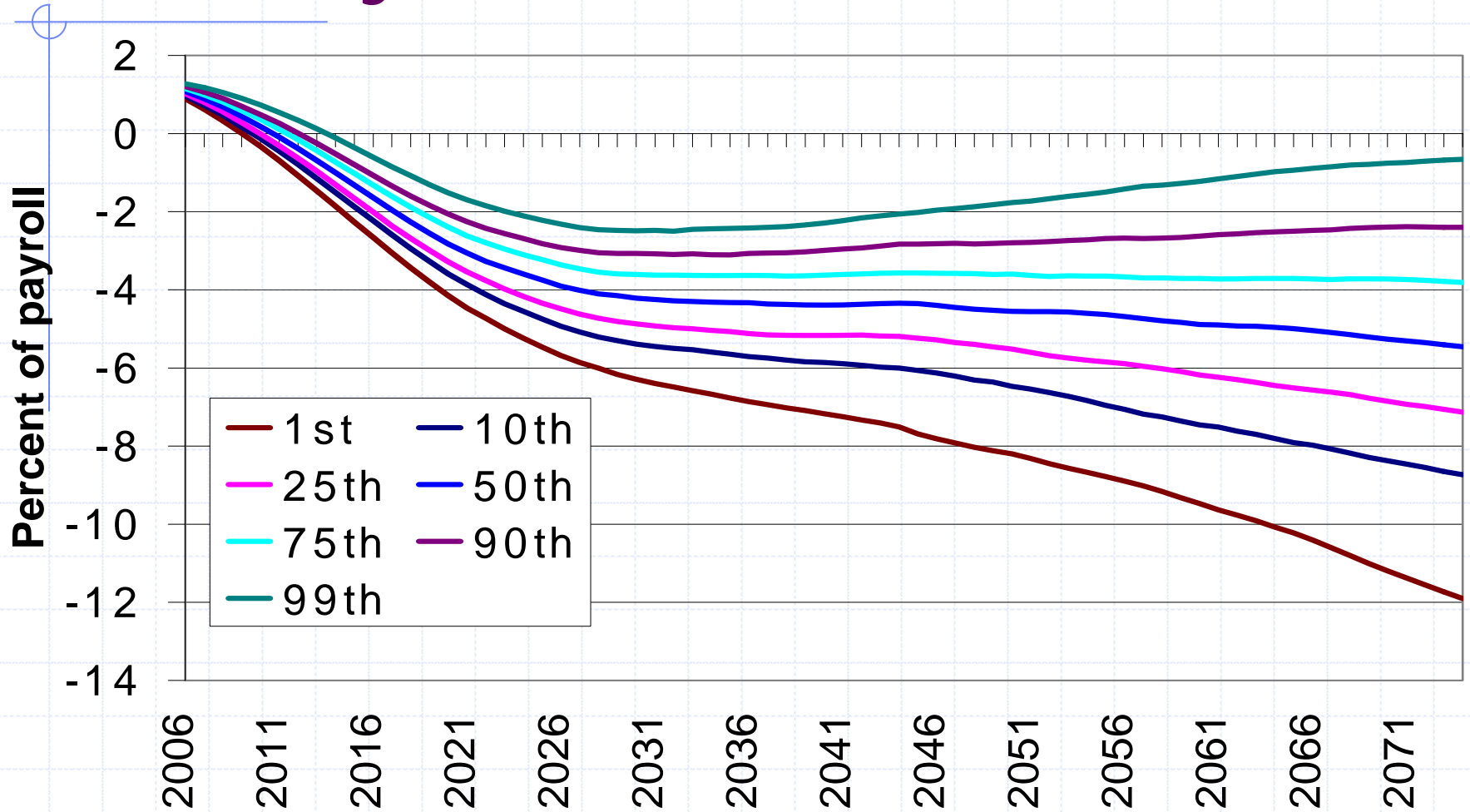
How should we require people to save?

- ◆ Much of Social Security is simply forced saving. But how much, and for who?
- ◆ U.S.: 12.4 percent of wages, up to ceiling of \$100,000 (290% avg wage ; OECD)
 - U.S.: Proposals to lift/eliminate wage ceiling
- ◆ Sweden: 18.5 percent of wages, up to ceiling of approx \$60,000 (132% avg wage)

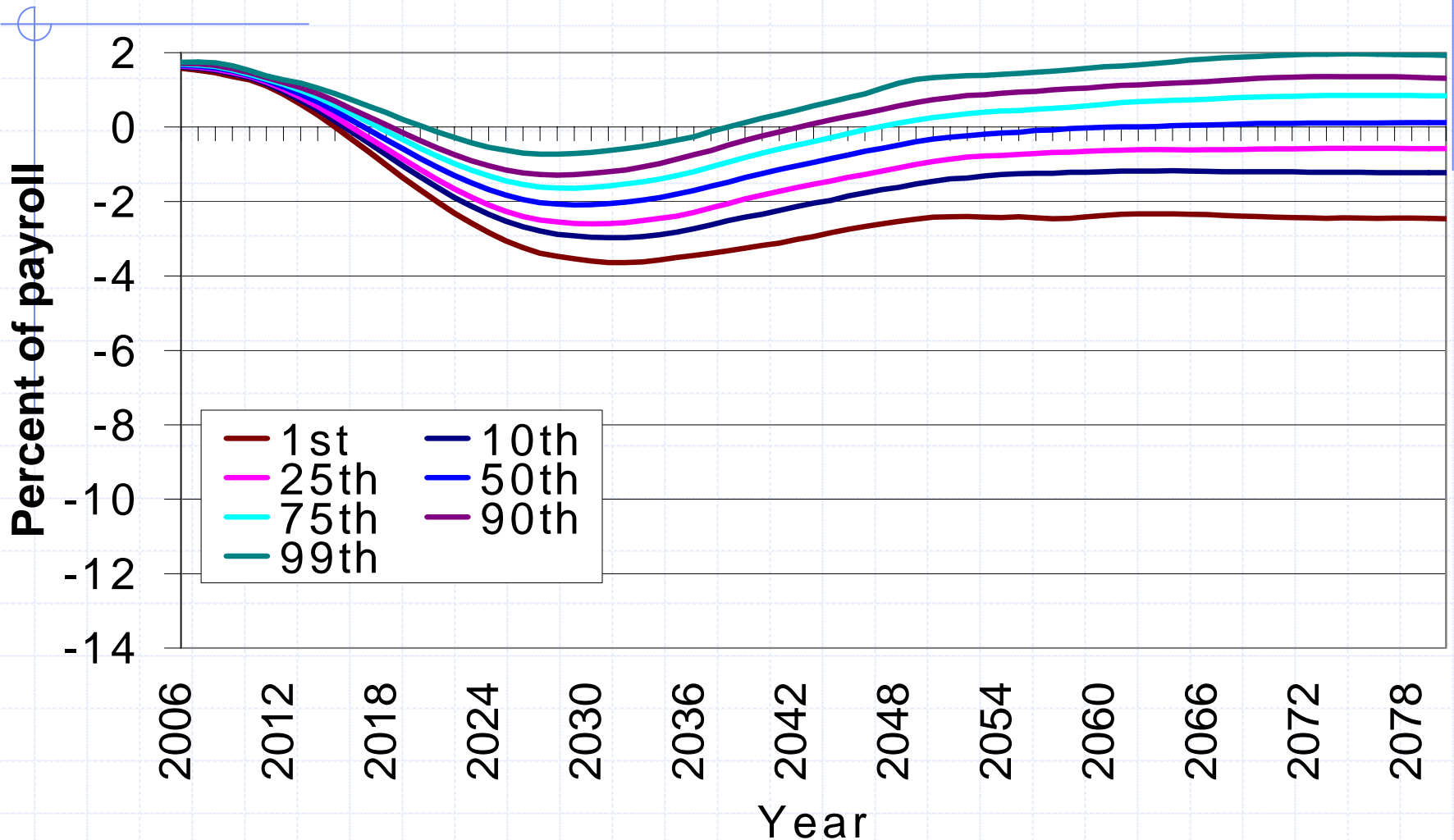
Resiliency

- ◆ Pension financing depends on on fertility, wage growth, longevity
- ◆ These factors highly uncertain; makes projecting/ensuring system financing difficult
- ◆ Sweden effectively controls for wage growth and mortality; does not control for fertility, but easily could
- ◆ Could auto-correction help in the U.S.?

Uncertainty of U.S. Social Security cash flows



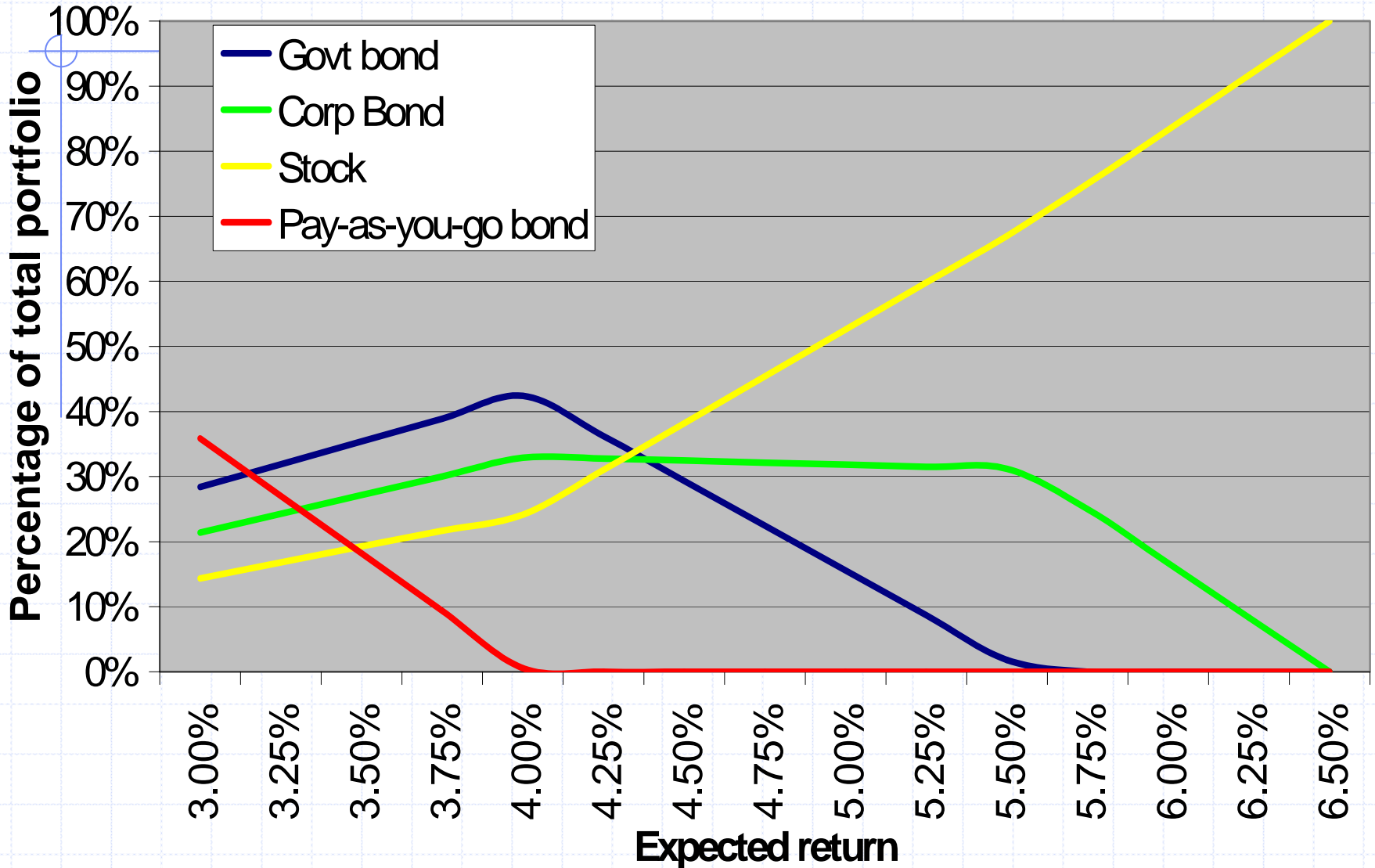
Social Security benefits indexed to worker-beneficiary ratio



Portfolio allocation

- ◆ Pay-as-you-go financing can be treated as an investment asset like stocks, bonds
- ◆ Sweden makes this explicit, but implicit in U.S. as well
- ◆ How does pay-as-you-go financing fit with other investments, based on relative returns and cross-correlations?

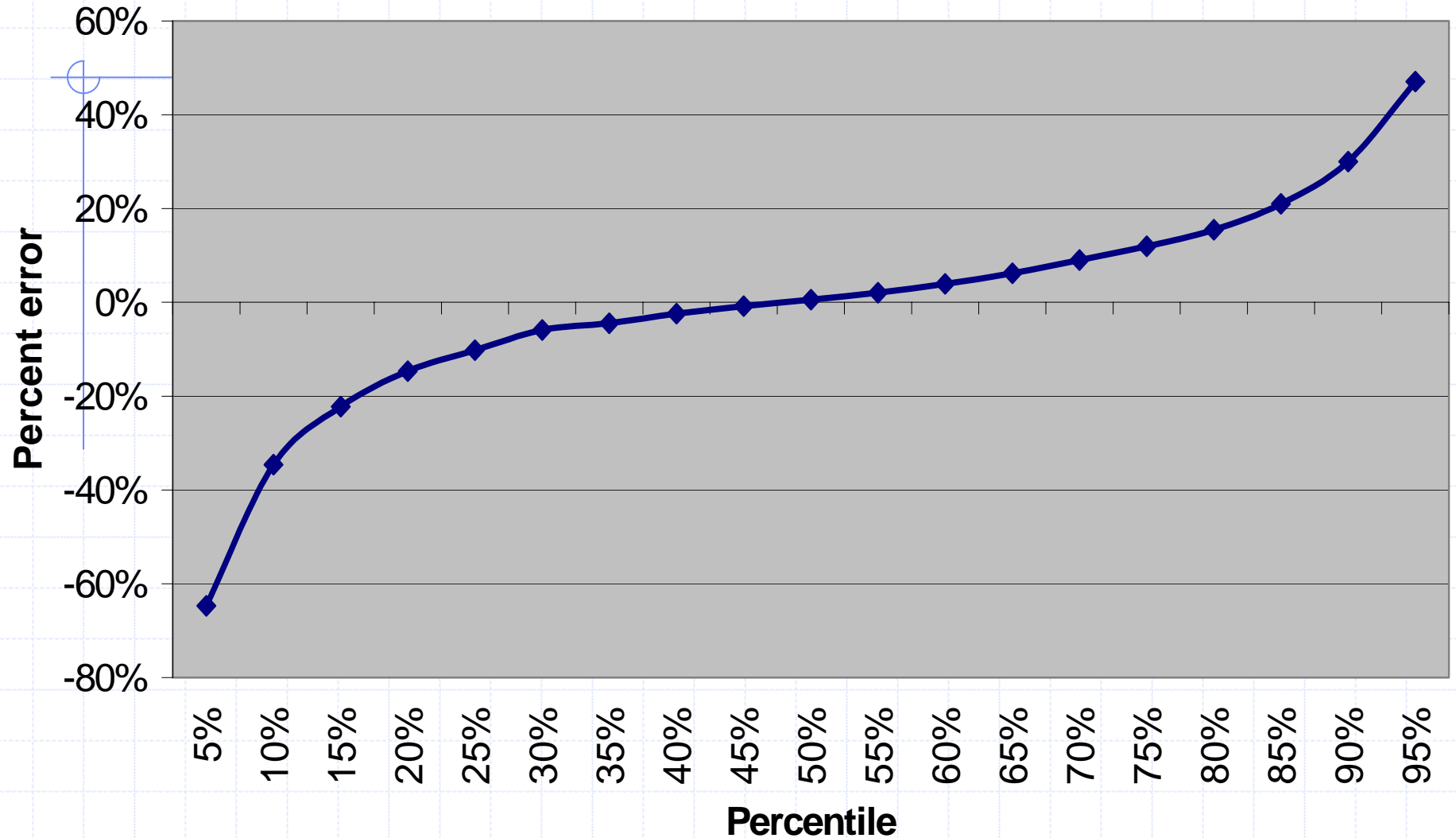
Asset allocations



Prediction risk

- ◆ Swedish program is far simpler than U.S. for typical retiree; complexity can undo advantages of DB pension
- ◆ U.S. benefit formula: wage index earnings, average high 35, run through progressive replacement rates, adjust for spousal benefits.
- ◆ Many Americans have little idea what their Social Security benefit will be until they collect, making other saving decisions more difficult

Estimation Accuracy of Initial Benefits



Source: Rohwedder & van Soest, based on HRS.

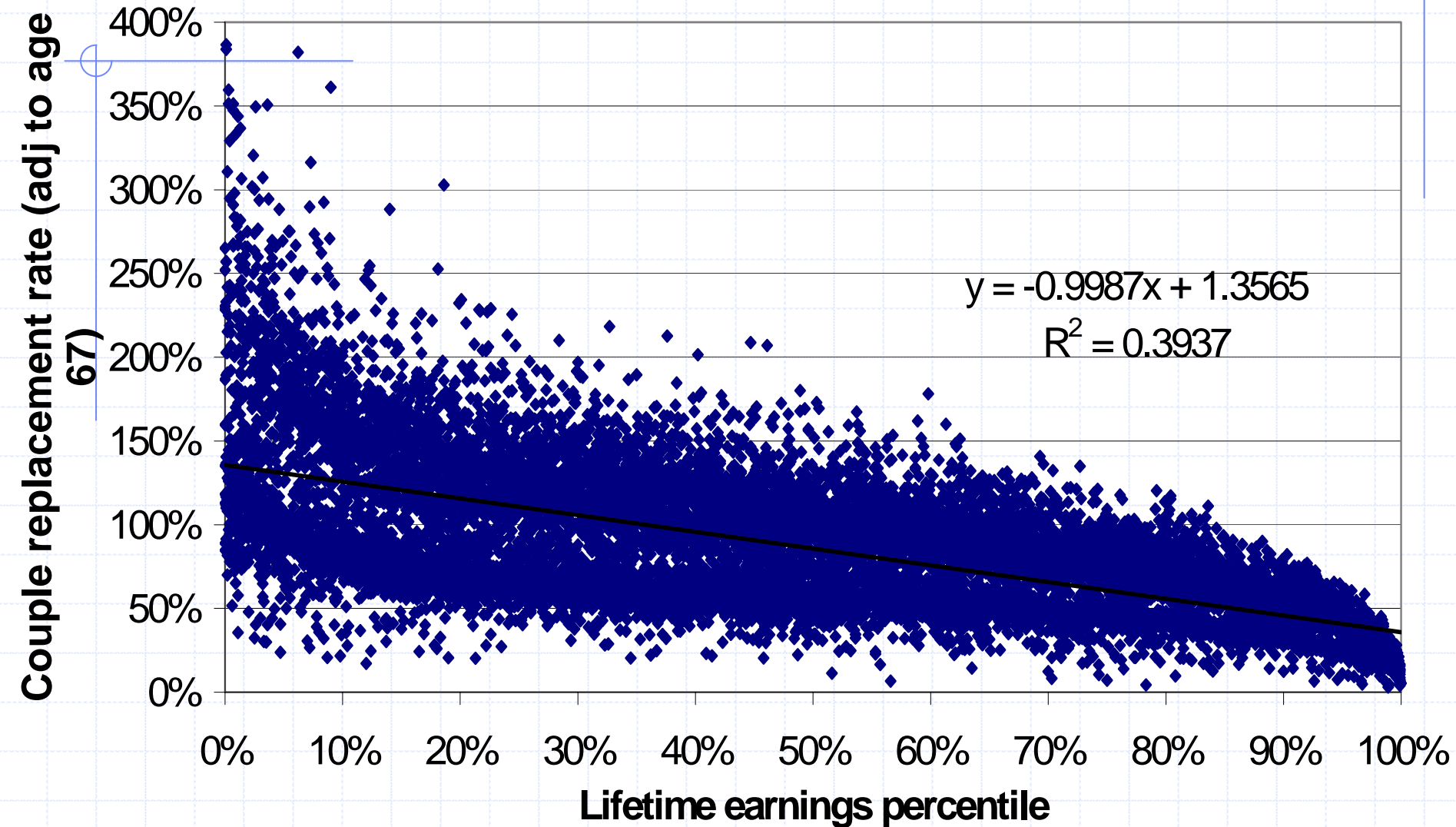
Targeting benefits

- ◆ Sweden less progressive, targets benefits less than U.S.
- ◆ U.S. Social Security targets based on earnings level, length of marriage, relative earnings between spouses
- ◆ Does U.S. gain much from targeting relative to simpler Swedish approach?

Social Security progressivity on average



Social Security progressivity: distribution



Disability

- ◆ U.S. Disability incidence rates haven't risen much; but younger disabled, lower mortality and Baby Boom mean rising DI population. Service economy should mean lower disability, but mental impairments more debilitating in service jobs.
- ◆ Benefits: Netherlands among most generous; U.S. middle of pack. Autor & Duggan find rising replacement rates for low earners in U.S. drive one-quarter of rise in filings. But Sweden has similar generosity with lower rolls than Netherlands.
- ◆ Redirection: Many counted as fully disabled in U.S. probably could work more (e.g., bunching of earnings below limits), but rolls would increase. Partial disability plus work requirement? What is employer's role?
- ◆ Health care: Unlike in Netherlands, Medicare eligibility significant incentive to claim DI. Health care reform could improve portability, break employer-health insurance link.