

Impact case study (REF3)

Institution: London School of Economics and Political Science		
Unit of Assessment: 25 – Area Studies		
Title of case study: Reforming pensions to protect adequate and sustainable benefits		
Period when the underpinning research was undertaken: 2000-2013		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s): Nicholas Barr	Role(s) (e.g. job title): Professor of Public Economics	Period(s) employed by submitting HEI: 1971 to present
Period when the claimed impact occurred: 2013-2020		
Is this case study continued from a case study submitted in 2014? No		
<p>1. Summary of the impact (indicative maximum 100 words)</p> <p>The Swedish pension system is widely studied and has become an exemplar for other countries. At the request of the Swedish government, Professor Nicholas Barr provided an external evaluation of their system. As a direct result of his report, Sweden is introducing two reforms that assist its 2.25 million pensioners.</p> <ul style="list-style-type: none"> • The minimum pension age will rise over time to reflect rising life expectancy. • The Premium Pension (in which workers choose from over 800 private pension providers) offers too much choice, so the number of funds will be substantially reduced. <p>These changes matter because they improve old-age financial security. The first reform protects the ability to continue to finance adequate pension benefits. The second, by reducing administrative costs, increases net pensions.</p> <p>Finland, also following recommendations by Barr, increased pension age and introduced more options to combine partial pension with continuing work for its 1.6 million pensioners.</p>		
<p>2. Underpinning research (indicative maximum 500 words)</p> <p>Research on the principles of pension design</p> <p>In a series of books and articles [1] [2] [3] [4], Professor Nicholas Barr and Peter Diamond (MIT, Nobel Laureate) set out the analytics of pension finance and their implications for pension design, drawing on developments in economic theory and demographics. The research was joint work. A core element was to frame analysis in second-best terms. Simple theory assumes that individuals make optimal choices and that labour markets, savings institutions, and insurance markets exist and function ideally. Formulating policy within that first-best framework is a useful analytical benchmark but a bad guide to pension design. Instead, analysis needs to take account of market imperfections such as imperfect information, non-rational behaviour, and incomplete markets.</p> <p>These explorations yielded a series of conclusions about pension design, including:</p> <ul style="list-style-type: none"> • Longer healthy lives are great good news but impose strains on pension finance. If benefit levels are maintained, the stress is on the financial sustainability of the system. If, instead, benefits adjust to available finance (as in Sweden), the stress manifests itself through lower pensions. In both cases, an implication is that pension age needs to adjust to changes in life expectancy. Since pensions exist to help people to plan over the life course, and since older people have less time to adjust to changes and, in the case of pensioners, fewer ways of adjusting, an important principle is that exposure to risk should decline with age. Thus a further implication is that changes should be phased in gradually, with no shocks for workers close to retirement. • A second set of implications draws on the findings of behavioural economics. In particular, faced by the need to make decisions about complex financial products, many people make bad choices: they do not save enough, make bad investment decisions, pay high administrative charges, retire too soon, and/or frequently do not annuitise enough. A central – and seemingly paradoxical – conclusion is that pension design is improved by offering workers a choice architecture with fewer options. <p>On the collaboration, Diamond wrote: “[Our] books have been well received ... and seem to me considerably better than either of us could have done alone. Doing better, rather than merely</p>		

*dividing the work, is the sign of a really valuable collaboration.... Indeed, we are at work on another book, going to issues not addressed in the earlier books” (quoted in Stuart Astill (2018), “Nicholas Adrian Barr”, in Robert A. Cord (ed.), *The Palgrave Companion to LSE Economics*, London: Palgrave Macmillan, pp. 823-4).*

Research on pensions in Sweden and Finland

Implemented with cross-party support, Sweden’s strategic reform of its pension system in 1998 has been emulated in other countries and widely studied. The system proved robust in the face of the 2008 economic crisis.

In 2012, largely as an outgrowth of Barr and Diamond’s research [2], the pension authorities in Sweden and, separately, Finland invited Barr to produce an assessment of their respective pension systems, not as crisis response but as prudent in-flight adjustment. The resulting reports [5] [6] both built on earlier research (“The analytical approach underpinning this report draws on Barr and Diamond (2008)” ([5], p. 43)), applying the analytical principles to the particulars of Sweden and Finland.

3. References to the research (indicative maximum of six references)

[1] Barr, N. and Diamond, P. (2006). [The Economics of Pensions](#). *Oxford Review of Economic Policy*, 22(1), pp. 15-39. DOI: 10.1093/oxrep/grj002. (Special issue on pensions co-edited by Nicholas Barr), reprinted in *European Economy, Quality and efficiency in education*, Special Report No. 3/2004, European Commission, pp. 61-85. Also published in Chinese, Czech, Hungarian, and Polish.

[2] Barr, N. and Diamond, P. (2008). *Reforming pensions: Principles and Policy Choices*. Oxford University Press. ISBN: 9780195311303.

[3] Barr, N. and Diamond, P. (2010). *Pension Reform: A Short Guide*. Oxford University Press. ISBN: 9780195387728. Also published in Chinese, Polish, and Spanish.

[4] Barr, N. and Diamond, P. (2011). [Improving Sweden’s Automatic Pension Adjustment Mechanism](#), Issue Brief Number 11-2, January 2011, Chestnut Hill, MA: Center for Retirement at Boston College.

[5] Barr, N. (2013). [The Pension System in Sweden](#). Report to the Expert Group on Public Economics (ESO), Ministry of Finance, Sweden. ISBN: 9789138240199.

[6] Barr, N. (2013). [The pension system in Finland: Adequacy, sustainability and system design](#), Evaluation of the Finnish Pension System Part 1, Finnish Centre for Pensions, Eläketurvakeskus. ISBN: 9789516911741.

4. Details of the impact (indicative maximum 750 words)

Impact: Sweden

The central recommendations of Barr’s report included that:

- The minimum pension age in Sweden should rise over time to reflect rising life expectancy: “...in addition to the application of the longevity coefficient at the time a person retires, there should also be a gradual increase in the earliest eligibility age” ([5] p. 96, and for surrounding analysis pp. 95-98).
- The Premium Pension (in which workers choose from over 800 competing private pension providers) offered too much choice: “Reform the premium pension, in particular to slim down choice sharply as, for example, in the Thrift Savings Plan or NEST” ([5] p. 79 and for surrounding analysis pp. 73-80).

As part of the launch event for his report [5], the main arguments were included in an op-ed article in a leading Swedish newspaper [A].

Pension age: In 2017, the Pension Group, the long-established cross-party body tasked with the maintenance of the pension system, agreed to raise retirement age [B]. Proposals in DS 2019:2 [C], initiated by legislation in 2019 [D], made the following changes:

- On 1 January 2020, earliest pension age increased from 61 to 62.
- In 2023, normal pension age will rise from 65 to 66 and earliest pension age to 63.

- From 2026, these ages will be based on a formula relating pension age to the remaining life expectancy of a worker's birth cohort at the time he/she reaches earliest pension age.

The number of plans: As part of the publicity for reform, Barr took part in a high-profile event [E] on 12 December 2017, as a double act with Richard Thaler (the 2017 Economics Nobel Laureate) at the Swedish Parliament, hosted by the Swedish Pension Group and the Minister for Health and Social Affairs, Ms Annika Strandhäll. An email to Barr the following day [F] from Elin Berglöf, Deputy Director Social Insurance Division and subsequently Secretary to the working group mentioned below, was enthusiastic:

"Thank you so much for an extraordinary presentation yesterday! I truly think it made a great impact [on] a lot of people present seeing it all at [once], and realising what it's all about ...Numerous people have called and emailed me to get your slides [G]. Is it ok with you that we put them on the government web page: regeringen.se?"

A follow-up op-ed article [H] reinforced the arguments.

In 2018, the pension group established a working group chaired by Mikael Westberg, former Chief Legal Counsel at the Swedish Pension Agency, to make proposals for reforming the Premium Pension, specifically to replace the previous system (which any provider could enter) with a procured platform with a simpler choice architecture. Together with the increase in pension age, these were the first significant reform proposals since the introduction of the system under the Pension Group's auspices in 1998.

In November 2018, at their request, Barr met the Chair and members of the working group at LSE to discuss detailed aspects of the reform, and over the course of 2019, detailed implementation was discussed by the Pensions Group, Parliamentarians, and officials, during which time Barr continued to comment on documents as they emerged.

In December 2019, the working group's report [I] was submitted to the Minister of Social Security [J], with recommendations [K] to establish a new agency to procure pension funds, with the three-fold task of reducing the number of funds, simplifying and improving the choice architecture for workers, and strengthening quality assurance.

In an email to Barr (19 November 2019 [L]), inviting comment on the report, Berglöf wrote that in drafting the report, *"we have tried to build as much as possible of the proposals on research, both behavioural economics and fund selection methodology"*, noting also that, *"sharing your knowledge and research, like you did with your presentation in December 2017, is a crucial way [of] helping the politicians make the right decisions, and giving them the necessary tools to make the required compromises"*. In responding to Barr and Diamond's further evidence [M], she wrote (20 March 2020), *"I have been using a lot of yours and Peter's brilliant quotes from your response, which has considerably increased the quality of the arguments in the Draft Bill"* [N].

The legislative process is under way, but with delays because of the pandemic. In February 2021, the Pensions Group agreed on the core of the reform, with an expectation of a final Parliamentary vote during summer 2021.

Impact: Finland

Barr's 2013 report on the pension system in Finland [6] pointed out that:

"The need for additional life expectancy to be divided in some sensible way between extra years of work and longer retirement is increasingly well-understood" ([6] para. 13), arguing for a phased increase in the minimum pension age:

"...there is a good case for making the adjustment at least in part by gradually increasing the earliest eligibility age without any compensating increase in pension" ([6] para. 208).

The report also argued that:

"It would [be] desirable if the pension system allowed partial deferral, e.g. the option to draw 25%, 50% or 75% of a person's pension, while the deferred element continues to grow" ([6] para. 13).

In 2014, after extensive negotiations between the Finnish authorities and representatives of

employers and workers (the social partners), an email to Barr from Jukka Rantala, Managing Director, Finnish Centre for Pensions, 12 November 2014, reported that:

"...the social partners in Finland...achieved an agreement on a major pension reform...many of the recommendations you gave in your evaluation of the Finnish pension system, will now be put into effect" [O].

After additional evaluation [P], legislation followed. The brochure sent to the public in 2017 included that:

"As of 2017, the general retirement age will rise by three months per year until it is 65 years" ([Q] p. 4).

"People live longer and longer. That is why the retirement age will be linked to life expectancy as of the year 2030. After that, ... [i]f life expectancy increases, the retirement age will rise by a maximum of two months per year" ([Q] p. 5).

And also that:

"You can draw your old-age pension in bits...regardless of whether you continue working or not" ([Q] p. 6).

Why these impacts matter

The brochure explaining the reforms in Finland stated that:

"The main objective of the reform is to encourage people to work longer. Extended working lives ensure adequate pensions and pension financing and intergenerational fairness. Although working lives are extended, the time spent in retirement will also grow as people live longer" ([Q] back cover).

The reforms contribute to that objective in several ways:

- Gradually raising pension age is necessary to protect the ability of the system to continue to pay adequate benefits to Sweden's 2.25 million pensioners. Since pension spending in 2017 was 7.2% of GDP, targeting of resources matters. The same is true in Finland, with 1.6 million pensioners, absorbing 13.4% of GDP in 2016.
- The ability to draw partial pension facilitates longer working life, with benefits both to the economy and individual well-being.
- An annual management charge of 1% over a full career will reduce a worker's pension accumulation (and hence his/her pension) by 20%. Reducing choice reduces administrative costs, and thus increases net pension benefits.

Wider impact

Research by Barr and Diamond [2] [3] has had wider international influence.

- Barr was a member of the Chile Presidential Advisory Commission on the Pension System in 2014-15, attending multiple meetings of the Commission in Santiago, Chile, and with an integral role in formulating the recommendations and drafting the final report [R]. Activities include briefing the President of Chile in a private meeting, together with Diamond. Some of the recommendations (including an increase in the Solidarity Pension) have been implemented. Others are currently in abeyance given unrest in Chile and the pandemic.
- He was also a member of the Advisory Board, [Network for Pensions in Latin America and the Caribbean](#), Project on Pension Indicators, Inter-American Development Bank, a project to provide quantitative assessment of the effectiveness of pension systems in 15 Latin American and Caribbean countries (2016-17).
- Barr and Diamond gave invited evidence [S] to an Australian inquiry into the design of default pension arrangements for workers who make no choice, as a result of which they were invited to submit further evidence [T]. The final report [U] cites that evidence on multiple occasions.

5. Sources to corroborate the impact (indicative maximum of 10 references)

- [A] N. Barr (2013c), "[800 pensionsfonder att välja mellan är för många](#)" ("800 funds are too many"), *Debatt*, 3 October. In Swedish, with English-language translation provided.
- [B] '[Partierna överens – pensionsåldern höjs till 64](#)' ("The parties agree – the retirement age is raised to 64"), *SVT Nyheter*, 13 December 2017. In Swedish.
- [C] Departementsserien och promemorior från Socialdepartementet, [Höjda åldersgränser i pensionssystemet och i andra trygghetssystem, Ds 2019:2](#) (Ministry of Social Affairs, Raised age limits in the pension system and in other security systems). Full report in Swedish.
- [D] [En riktålder för höjda pensioner och följsamhet till ett längre liv](#) [Socialförsäkringsutskottets bet 2019/20:SfU5](#), Sveriges Riksdag (A target age for increased pensions and adherence to a longer life, The Social Insurance Committee's report 2019/20).
- [E] [Pensionsseminarium med nobelpristagare Richard Thaler: How to make the Swedish pension system great again](#), Regeringskansliet (Ministry of Social Affairs, Pension seminar with Nobel laureate Richard Thaler: How to make the Swedish pension system great again), 4 December 2017.
- [F] Email to Nicholas Barr from Elin Berglöf, Deputy Director, Social Insurance Division, 13 December 2017.
- [G] N. Barr (2017a), "[Pros and cons of the Swedish pension system in an international perspective: Adjusting the system but keeping the faith](#)" (seminar presentation made available on Swedish government website), 12 December 2017.
- [H] N. Barr, P. Diamond and S. Lundbergh, "[Forskare: Utforma pensionsvalet efter människors beteende](#)" ("The Premium Pension reforms - the end of the beginning"), *Dagens Industri*, 11 April 2018, [English-language translation](#) provided.
- [I] [Ett bättre premiepensionssystem](#) SOU 2019:44 Regeringskansliet (A better premium pension system, Ministry of Social Affairs), 4 November 2019.
- [J] [Utredning föreslår reformerat premiepensionssystem](#), (Inquiry proposes reformed premium pension system, Ministry of Social Affairs), 4 November 2019.
- [K] "[Förslag: PPM ska bantas med hjälp av ny myndighet](#)" ("Proposal: PPM should be reduced with the help of a new authority"), *SVT Nyheter*, 4 November 2019.
- [L] Email to Nicholas Barr from Elin Berglöf, 19 November 2019.
- [M] N. Barr and P. Diamond, [Refining the choice architecture in the Swedish Premium Pension: Response to the consultation on Ett bättre premiepensionssystem](#) SOU 2019:44, February 2020.
- [N] Email to Nicholas Barr from Elin Berglöf, 20 March 2020.
- [O] Email to Nicholas Barr from Jukka Rantala, Managing Director, Finnish Centre for Pensions, 12 November 2014.
- [P] Finnish Centre for Pensions, [Effects of the 2017 earnings-related pension reform: Projections based on the government bill](#), by Kaarlo Reipas and Mikko Sankala, August 2015.
- [Q] [Pension Reform 2017](#), summary report produced by the Finnish Centre for Pensions.
- [R] [Informe Final, Comisión Asesora Presidencial Sobre El Sistema De Pensiones](#), (Final report of the Presidential Advisory Commission on the Pension System), September 2015. English-language [Executive Summary](#) provided.
- [S] N. Barr and P. Diamond, "[Designing a default structure: Submission to the Inquiry into Superannuation: Assessing Efficiency and Competitiveness](#)", Australia Productivity Commission, September 2017.
- [T] N. Barr and P. Diamond, "[Response to Superannuation: Assessing Efficiency and Competitiveness: Productivity Commission Draft Report](#)", Australia Productivity Commission, 17 July 2018.
- [U] [Superannuation: Assessing Efficiency and Competitiveness](#), Australia Productivity Commission Inquiry Report, No. 91, 21 December 2018. (Barr and Diamond cited pp. 221, 228, 248, 538, 561, and 571.