



Iceland: New legislation reforming the public old-age pension system

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Parliament has just adopted a major simplification of the public pension system, aiming to reduce three benefit types to one unitary old-age pension benefit. Calculations in the income-testing mechanism are also to be simplified. This will be combined with a gradual rise in the statutory pensionable age (from 67 to 70) and a significant short-term rise in the level of pension income for the majority of pensioners. Work incentives will however be significantly reduced. This will be effective as from January 2017.

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Description

The Icelandic pension system has three pillars: the first one comprises public old-age and disability schemes; the second one covers the mandatory Occupational Pensions from the Occupational Pension Funds (OPFs), run by the labour market partners; and the third one consists of voluntary funded Individual Pension Accounts. Iceland's governments have been trying more or less since 2005 to simplify the public pension system with a view to improving the interaction between public pensions and occupational pensions, i.e. the first and second pillars. These interactions have been characterised by controversial income-testing rules in the public pension system. Three task forces have delivered proposals for such changes, in 2009, 2013 and the latest in February 2016 (Velferðarráðuneytið 2016). These proposals have been based on somewhat different policy premises though. The last one is the only one that made it to parliament. It was passed on the 13th of October 2016 and will enter into force as from January 2017.

The changes passed apply only to public old-age pensions (disability pension reforms are supposed to follow later).

The main aims of the new legislation are the following:

- To simplify the public pension system by unifying three pension benefits into one old-age pension (basic pension + income supplement + minimum pension guarantee). On top

of that a home supplement (*heimilissuppbót* – a benefit for keeping one's own home) will still be paid to single pensioners (as in the present system).

- To abolish the special free brackets (*frítækjumörk*), i.e. exemptions from income-testing (for income from employment, income from pension funds and financial income). This is expected to achieve further simplification of the system.
- To increase the public statutory pensionable age gradually from the present age of 67 to 70, for both men and women, over a period of 24 years.
- To increase flexibility for effective retirement age. It will be possible to take up public pensions at age 65, with reduced pension entitlement (instead of 67 now). The scope for delaying take-up will also be increased at the upper end, from 72 to 80, with a comparable yearly increase in entitlement (6% per year).

The policy aims underpinning these changes, in addition to simplification, are said to be a stronger subsistence base for old-age pensioners, as well as increased incentives to work longer. They are also a response to rising life expectancy and to a rising disability burden for the OPFs.

A part of the change is an increase in the level of the public old-age pension for those pensioners with current overall

income in the range of 250,000 to 400,000 I. Kr. per month (i.e. €1975 to €3160). Increases depend on the extent of other incomes, besides the public pension, and range from just above 0 to 9.2%. This change of system is expected to increase the overall pension income of about 86% of pensioners, while about 14% will see a reduction in their public pension (mainly those with higher income from other sources, such as from OPFs).

This rise is expected to increase public expenditure on pensions by about 15% when it reaches its maximum level (by year 2019-2020), but with the higher pension entitlement age the extra costs will gradually decline again from then on (Talnakönnun October 2014. p. 16, with an update).

Outlook & Commentary

The major change in the new legislation is the simplification of the structure of old-age pension benefits, which has been generally well received. A higher statutory pensionable age (67-70) along with increased flexibility for take-up of pensions has also been generally well received (see parliamentary documents – cf. Alþingi 2016).

Negative reactions from pensioners' organisations involve criticism of the abolition of the free income brackets for employment earnings and other income, including on income from the OPFs. These are seen as reducing the incentives to work while claiming a pension, as well as reducing incentives for the

personal accumulation of savings. These effects actually run counter to the government's stated goal of increasing work incentives.

In addition to abolishing the free bracket allowances, income-testing of public pensions with reference to other income is increased across the board, i.e. the reduction due to other income is increased from 11%-38.3% for different benefit types, up to a universal reduction rate of 45%. This runs counter to a long-term stated aim amongst pensioners of reducing the degree of income-testing in the public system (Ólafsson 2012).

These negative reactions have been quite prominent in recent weeks. This led the government to partly give in to the criticism at the last stage. On the 7th of October, the government announced a change in its proposals, reintroducing a universal free bracket on all income other than the public pension.

The sum of the new exemption from income-testing is of the order of 25,000 I. Kr. per month (198 Euros). This comes instead of a free bracket exemption on employment earnings, presently about 120,000 I. Kr. (962 Euros) and about 27,400 I. Kr. (220 Euros) on occupational pension income, still a significant reduction of the allowance for employment earnings. This change will however involve a greater overall increase in pension income level than the original proposal, thus making the change more appealing than before.

The government also proposed at the last stage in the parliamentary

process a closer link between the increase in the minimum old-age pension and the collectively bargained rise in the minimum wage on the labour market, up to 2018 (not formal indexation though). That also made the overall package even more enticing. Pending elections possibly explain that move.

The reduced work incentives that these changes to the public old-age pensions involve will, however, probably make it more difficult, in the coming months, to adapt the disability pension accordingly, since work incentives are much more important to disability pensioners than to old-age pensioners (old-age pensioners already have high effective retirement ages).

Further reading

Velferðarráðuneytið (2016). [Skýrsla nefndar um endurskoðun almannatryggingakerfisins](#) (Report on reforms in the public pension system). Reykjavík: Ministry of Welfare.

Talnakönnun (2014). *Kostnaðaráhrif af tillögum nefndar um endurskoðun almannatrygginga* (Report on cost of proposed pension system changes). Reykjavík: Ministry of Welfare.

Stefán Ólafsson (2012). "Lífeyrisþegar – fjölgun og afkoma" (Pensioners – increased numbers and income levels), in Eydal and Ólafsson (eds.), *Þróun velferðarinnar 1988-2008*. Reykjavík: Félagsvísindastofnun H.Í.

Alþingi (2016). Documents from the Parliament's Welfare Committee (see here).

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