Efling - Trade Union

Kjarafréttir

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Pensioners who cohabit get on average a pension to the tune of **209,382kr** from pension funds and **171,975kr** from social security (TR), according to 2020 tax returns. Combined pension payments were thus on average just under **381,356kr** before taxes. After taxes, this came to about 300,000kr a month. At the same time, the average wages of full-time workers in the country were about **730,000kr** (regular gross pay). Pensions are thus very low in Iceland. The average is a median, which means half of pensioners are living on **less than this amount**.

On average, the combined pensions of retirees (71 years and older) are just over half of the gross pay of those of working age. This is a low pension, and cause for surprise in a country that prides itself in having "the best pensions system in the world". How can this be?

The pensions system comprises in the main the labour market pension funds, and the social security system (TR). Iceland has the third largest pension fund system in the OECD, but one of the very smallest old-age social security programmes of that group. Social security contributions to pensions are too low. Danes, who also have a strong pension fund system, spend about three times more as a share of GNP than Icelanders on old-age pensions from social security (in addition to what is paid by pension funds). That's where the fault lies in Iceland. The social security contribution is too low by far.

The guideline of social security pensions is too low (lower than the labour market's lowest wages) and means testing of income from pension fund payments begins far too early (at the 25,000kr limit). Retirees' gains from pension fund savings are too low and too many retirees get stuck at too low an income. Taxation of low pensions is also very high in Iceland.

Low retirement pensions in "the world's greatest pension system"!

Few retirees in Iceland have a good pension, unless they've worked most of their working lives in the public sector at a decent wage or been very well paid in the private sector. People who have worked mostly in the private sector and received low or medium wages tend to have a very low pension, especially if they live with a partner, like most retirees do.

When it comes to the "worry-free golden years", most people get less paid in pensions than they expected. How come?

This has two main causes.

Firstly the amount people get from pension funds isn't higher because the promised pension fund payments in the private sector were, for a long time, only 56% of one's average lifetime wages. This meant an even lower share of the final wages at the end of one's working life (often about 45%). This drop in incomes is high for those who've mostly worked in the private sector. Pension dues were also, until 1990, not paid off one's total wage bill, and the dues percentage wasn't high enough.

In 2016, there was a negotiation to raise the pension dues percentage in the private sector from 12% to 15.5% to inch toward the public sector pension situation. This was a good aim, but it would only have been finally achieved until a whole working life later, i.e. in 2055. This will not happen, because this year, the rights in pension funds in the private sector were lowered by about 10% based on retirement at 67, from 72% to 62%, due to the projected extension if life expectancy.

The public sector provided its workers with 76% of average lifetime wages – and still does. Pension payments have thus been much better for public sector workers and will remain so for the foreseeable future. This lifts the national average in terms of retirees' income, but the pension of those who've worked in the private sector for most of their life are significantly worse than these averages indicate.

Secondly the social security (TR) contributes too little in addition to the pension fund payments, due to an excessively low basis of calculation from TR, and because of steep means testing of pension fund income. The more pension funds have paid in recent years to retirees, the less TR has paid, because of ever-steeper cuts. When pension payments go above 25,000kr a month, the income threshold, full cuts are implemented which prevent retirees from enjoying the fruits of their pension savings.

What is the actual pension and disposable income of retirees?

Image 1 presents the pension people got, from social security and the combined total, in 2020. We see how much each income bracket gets. Group I is the tenth of retirees who get the least, X is the tenth which gets the most. The median is shown on the right.

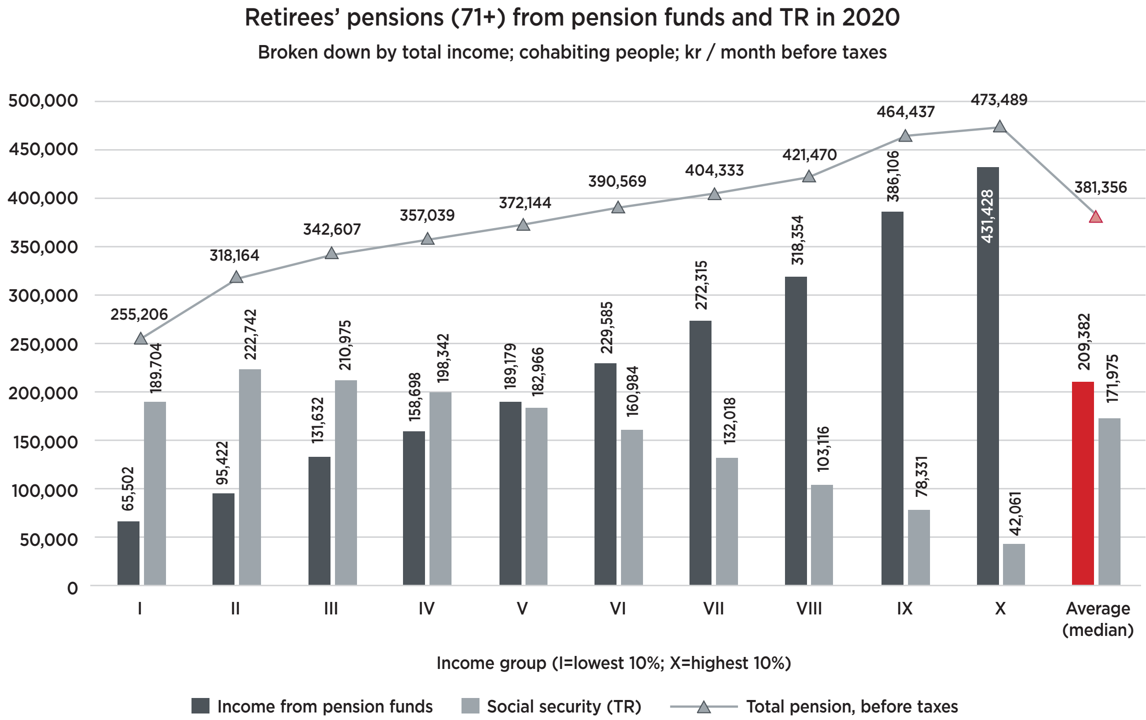

Image 1 Pension payouts to retirees (71+) in 2020, by income decile, from lowest (Group I) to highest incomes (Group X). Pension fund and social security contributions are shown separately (columns) with the sum shown on the marked line. All numbers before taxes. Source: Prime ministry's Income history (Tekjusaga), 2022.

The left side of the image are the retirees with the lowest pension fund payments, who get the highest social security (TR) contributions. Those who get most from TR still get no more than 211-220 thousand a month (groups II and III). Single pensioners who live alone get about 65,000kr more (home supplement).

In the lowest decile (group I), the payments are lower, probably because people who have not lived in Iceland their full working lives don't have full TR rights (which require 40 years of residence in Iceland). They need to get municipal poverty aid to make ends meet. In general, the picture shows how many retirees have low total pensions. Half of those over 70 have less than 381 thousand a month in combined pensions. This is reduced by 80 thousand by taxation.

The picture also shows how TR payments drop as the pension fund contribution rises, step by step. For people with up to about 600,000kr a month from pension funds, TR pays some additional contribution. **The median pension fund payment is 209,382kr, with nearly 172,000kr from TR**. The median is the number in the middle of the income ladder of pensioners, with half getting less and half getting more. The normal average is higher in terms of pension fund payments, **227,803kr**, but lower from TR, with nearly **152,134kr**. The average is higher than the median, because the pension fund payment scale stretches some distance upward.

The overview table below shows the median and average of pensions as a proportion of total wages (including wages and capital gains) and disposable income after direct taxation. This also shows the corresponding numbers for the lowest and highest income decile.

Overview of pensioners' income in 2020: Pensions, gross income and disposable income For pensioners 71 years or older, cohabiting				
	Median	Average	Lowest decile	Top decile
Pension fund payments	209,382	227,803	59,907	419,027
TR pension	171,975	152,134	184,673	37,452
Pensions, total	**381,356**	**379,937**	**244,579**	**456,479**
Total income before taxes	418,000	505,712	266,167	1.265,291
Disposable income after taxes	321,009	381,713	225,393	917,045
Source: Prime ministry's Income history (Tekjusaga)				

These numbers demonstrate that most retirees mostly depend on pensions for subsistence. This is evident by the small difference between the combined pensions and the gross income, except for the very highest income decile. That half of retirees at the lower end of the income scale only adds about 22 to 45 thousand kr in wages and capital gains, but those with the highest incomes get an additional 809 thousand in such income along with their pensions (which comes mostly from pension funds).

In light of the fact that most retirees depend on pensions to live, the amounts they get are very low. The average income of full-time workers at a working age were 730 thousand at this time (about 793 thousand when extra work was included). The average pension of retirees was thus only about 50% of the average income of workers, despite public sector workers and high income people raising the average. Private sector workers are seeing a proportion closer to 40-45%.

The combined pension of retirees form TR and pension funds is thus very low. Taxes are deducted off what's paid out, an average effective taxation of 23.6%. It is lower for the lowest-paid, but a great majority of retirees are paying more than 20% in taxes, which is high, given how low their income is. Half of retirees have less than 321 thousand a month in disposable income (the median). The 10% of retirees with the lowest income have 225 thousand in disposable income a month. The highest paid have 917 thousand a month after taxes.

Were the pension funds established just to relieve the state of pension liabilities?

TR means testing of pension fund income amounts to over 50% of people's pension fund income, with income tax remaining to be deducted (over 20%), meaning that the benefit from increased pension fund payments is only 20-30% of every 100,000kr people get from the funds. This applies to people getting 25-600 thousand kr a month from the pension funds. These extensive TR cuts, and high taxation of low incomes, make a farce of the pension fund system. The state is being released too early and too fast from its social security old-age pension liabilities. Nearly all the yield of pension investments in fact goes to the state, not to improve the pensioners' lot.

The result is a combined pension fund and social security payment that is too low for most retirees. The appearance of pension funds has thus mostly (70-80%) had the effect of relieving the government of pension payments. **The improvements to retirees are a minor factor (20-30%)**.

The goal of establishing the pension funds in the 1969 collective agreements was to raise the old-age pension, not to take pension payments off the government's shoulders. But that has been the end result.

The surprisingly low contribution of the state to social security pensions

One result of the government's excessive means testing in the social security system is that the government's old-age social security pension bill is among the West's lowest.

This can be seen in image 2.

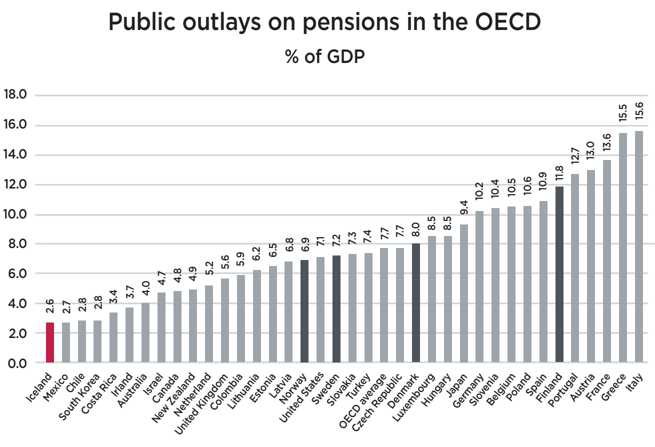

Image 2 Public expenditure on old-age pensions via social security in OECD states, 2017. Source: OECD.

The Icelandic state only contributes 2.6% of GNP to pension payments, while Danes, which have large funds like we do, pay about 8%, about triple. Iceland is an absolute outlier.

On average, the greater share of retirees would have to get 100-150 thousand more from social security as they now do, so that the pension system could honestly be called a good one. This could most easily be done by raising the income limit for social security means testing of pension payments, from 25,000kr a month to 100-150,000kr.

It would also be desirable to reduce direct taxation of pensions, like most western states do. Tax on low incomes is too high in Iceland generally – while taxation of high incomes and capital gains especially is rather low, compared to other nations.

It is also important to greatly simplify the means testing apparatus within social security, so the public can understand how the system works. This is important to prevent the government from continuing its super-cuts within the system.

Don't we have the "best pension system in the world"?

Why do so many retirees have such low pensions and such low disposable income? How does this chime with the repeated claims about Iceland having one of the world's greatest pension systems?

The most recent example of such a statement comes from an international consultancy firm, the Mercer/CFA Institute, last year (**see here**). Their conclusions are largely based on OECD projections of what the pension systems will give to an individual who starts working in 2019, after at least 40 years of work, who'd start taking pensions well after 2055.

This is, in other words, a calculation stretching 40 years into the future. Previous statements of this nature have also based on such projections.

Let's take a closer look at what this entails, and why previous projections haven't held up.

The last analysis (the Mercer-report and the OECD report Pensions at a Glance) bases the projection on the year 2019, just after the private sector pension dues had been raised from 12% to 15.5%, which was supposed to raise the pensions claim from 56% of average lifetime wages to 72%. The starting position looked well enough. But how likely is it to hold up for 40 years? There can be many roadblocks on the way, the biggest of which we'll take a closer look at.

1. In recent decades, **the state has greatly increased social security cuts**. The pension rights projection made 20 years back didn't hold up, precisely because the social security provisions were slashed in the intervening time. The baseline for means testing of pension payments was 25 thousand a month in 2008, and remains there (further depreciated because capital gains are now also included). If the baseline had risen along with wages, it would be at 62 thousand a month now. This means that TR cuts based on pension fund payments have increased enormously. The steepness of cuts was also raised, last in 2017. This nullified the projection of pension quality.

2. Will we see this continue, the government taking an ever larger share of rising pensions by means of steepening cuts? There is little cause to expect anything different. That would negate the Mercer/CFA and OECD projections and make their proclamation of Iceland's "greatest pension system in the world" void.

3. The projection also assumes generous **private pension contribution** to pension payments in the years after 2055. Recently, an ever larger share of this has been used to pay down mortgages and subsidize consumption in crises, most recently during covid. In next year's government budget, there are plans to expand the permission to do this even further, allowing the use of the 3.5% supplemental pension, negotiated in the 2016-18 contract, to pay down mortgages. The amounts thus withdrawn from the private and supplemental pension won't be available at retirement. That will be a hole in the projection.

4. The latest projection was based on pension fund liabilities in 2019, just after dues had been raised and rights expanded. However, **pension funds have lowered rights to pensions this year** (based on retirement at 67), due to longer projected lifespans. The downgrade is generally 10%, nearly half the increase private sector workers were poised to gain by the rise in dues 2016-18. This part of the projections won't hold up.

5. In 1995-2019, **the government raised taxes on low incomes, including pensions**. This has radically revised the preconditions for pensioners' income. If this continues, the Mercer/CFA projections won't be fulfilled.

These are big items which will erode the projection for the "best pension system in the world". Further factors may enter the picture, voiding the 40 year calculation. We are justified in taking these arithmetical exercises with a grain of salt, exercises which have been the basis for claims about Iceland having the "best pension system in the world". **So far, they've been illusory**.

Conclusion

We're faced with abnormally low pensions, and total income, for retirees in Iceland. This is due to excessive cuts in the social security system. The free-income limit for pensions, exempt from means testing, must be raised to fix this. Raising it from 25 to 100 thousand a month would only cost the government 15 billion, a mere 10 billion when netting out taxes. That would be quite manageable.

The basic social security pension (the full amount, without cuts, from TR) is too low. It is now about 5% under the lowest labour market wage. That is a disgracefully low amount, going to those who rely mostly on social security. This also leads to those with average pensions or less, paid by pension funds, getting way too little in addition from social security.

The taxation of low pensions is also too high. The simplest way to fix that is to lower the tax rate in the lowest bracket, which would also help working people. Other means are also available.

The conduct of the state, especially after 1995, has caused great damage to the social security system, with steep cuts off too low a basis. This can be seen in the insufficient pensions being paid to most retirees today. The same goes, with even greater force, for disabled pensioners, who rely even more on social security.

Previous instalments of Wage news (see at www.efling.is):

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