Chapter 3

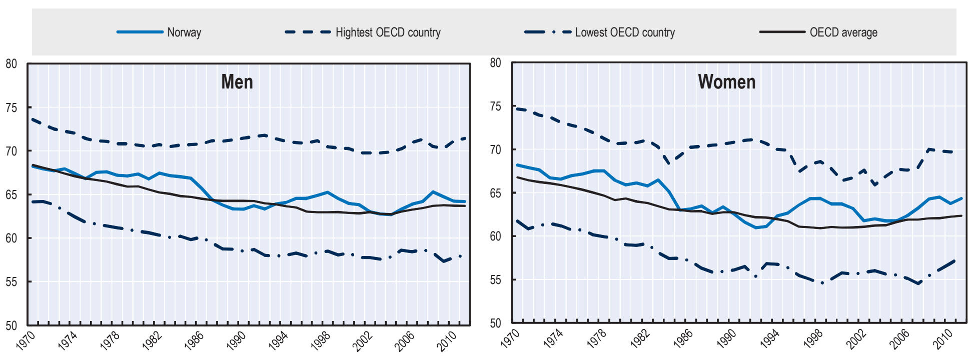
Making work rewarding for Norwegian seniors

Prior to the 2011 reform, the pensionable age in Norway was 67 – yet a large share of employees left the labour force before that age, mainly via disability benefits or the Contractual Early Retirement schemes (AFP) implemented in the late 1980s. In 2010, 58% of the population aged 62-66 received a pension; 35% of that share received disability benefits and 20% AFP. This chapter analyses Norway's actions to strengthen financial incentives to carry on working, including reform of its old age pension system and early retirement schemes.

Changes in the exit age

As noted in Chapter 2, the effective labour force exit ages for both men and women in Norway exceed the OECD average. Nonetheless, it is instructive to chart the developments surrounding this indicator. The effective labour force exit age fell at the end of the 1980s. For women, the exit age has increased since reaching an all-time low at the beginning of the 1990s; the exit age for men, while exhibiting some fluctuation shows no clear trend (Figure 3.1).

Figure 3.1. **Effective labour force exit age[a] by gender, OECD countries, 1970-2011**



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a) The effective labour force exit age (also called the effective age of retirement) is calculated as a weighted average of the exit ages of each five-year age cohort, starting with the cohort aged 40-44 at the first date, using absolute changes in the labour force participation rate of each cohort as weights.

Source: OECD estimates based on national labour force surveys.

The 2011 pension reform

Key features

One reason for the high number of people leaving the labour market through alternative pathways before the age of 67 is that in most cases, losses in old age pension benefits were small. Also, the possibilities of combining income from work with a pension and without a financial penalty were restricted. Thus, the main objectives of the pension reform in 2010-11 were to increase the incentives to work and facilitate work opportunities for retirees (Box 3.1).

Box 3.1. **The 2011 old age pension reform: Basis for calculations**

The reform introduced a flexibility that made it possible for persons between the ages of 62 and 75 to draw old age pensions. In order to access the pension before the age of 67, the pension must, when the person in question attains the age of 67, be at least equal to the minimum pension level for those with an insurance period of 40 years.

The pension may be drawn fully or partially; the drawing alternatives are 20%, 40%, 50%, 60%, 80% and 100%. Work income and the pension may be combined without deductions in the pension. If one continues to work, additional pension entitlement is earned, up to and including the year in which one reaches age 75, even if one has already started drawing the pension. Pensions drawn with effect from 2011 and after are subject to a life-expectancy adjustment.

Pension payments will be indexed to wages, and then be subtracted by 0.75%. The minimum pension level will be indexed to wages, but adjusted according to the effect of the life-expectancy adjustment for pensioners who are 67. Pension rights in the course of acquisition will be indexed to the average wage rate.

New provisions have been introduced relating to pension calculations for people born after 1953. For those born between 1954 and 1962, part of the old age pension will be calculated according to the new earning provisions, and part according to the old. People born in 1963 or after will have their entire pension calculated in line with the new earning provisions.

All income earned between the ages of 13 and 75 counts towards the pension. For each year of pension earned, a pension capital is accumulated, amounting to 18.1% of income. All income up to a maximum of 7.1 times a base amount (in 2012, NOK 576 186) is included in the calculation.

The pension is calculated by dividing one's pension capital by an annuity divisor. The divisor is determined on the basis of the remaining life expectancy at the time pension drawing begins. This mechanism results in an annual pension amount that will be higher the longer the pension drawing is deferred. The system is designed to be actuarially neutral, meaning that the sum of the old age pension one receives during one's period as a pensioner is independent of the date when the pension drawing starts.

Those who are currently insured for pension purposes, and who have a total insurance period of three years between the age of 16 and the year they become 66, are entitled to a guaranteed pension. The condition of current insurance affiliation does not apply to those who have been insured for at least 20 years (on the basis of periods of residence, etc.).

The guaranteed pension is granted at two different rates, depending on marital status and the income of the spouse/cohabitant. It is determined on the basis of the insurance period, and is independent from both previous income and paid contributions. A person who has at least 40 years of insurance is entitled to an unreduced guaranteed pension; the amount is reduced proportionally in the case of a shorter period. The guaranteed pension is reduced by 80% of the income-based pension.

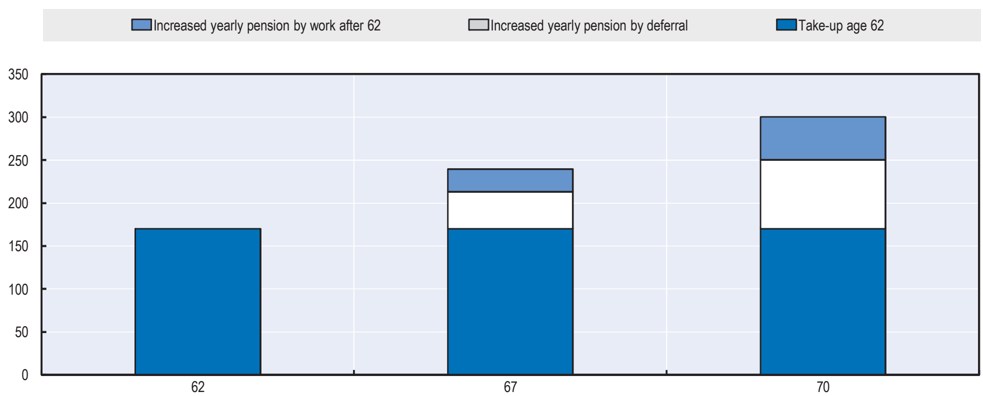
Source: Ministry of Labour, Norway.

Increased flexibility and better incentives to work

The 2011 reform introduced flexibility into the pension system. The statutory retirement age of 67 was abolished, and actuarial methods for calculating pension benefits began to be applied. This means that take-up of pension benefits is now possible at any age between 62 and 75. A demographic component is factored into the pension calculations to take into account the effect of increased life expectancy at retirement age. Work income can be combined with benefits from the public pension system without any earnings test, and generates additional pension rights even after take-up of the pension.

Figure 3.2. **Simulation of effects of taking up a pension at 62, 67 or 70,[a] Norway, 2012**

NOK 1000



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a) Annual pension assuming a person belonging to the 1963 cohort, who at the age of 62 is registered with a stable annual income of NOK 471 000 over 40 years.

Source: Ministry of Labour, Norway.

The effect on yearly pensions of deferring total withdrawal from the labour market and generating additional pension rights after the age of 62 is illustrated in Figure 3.2. If a person earning a stable income over a career of 40 years makes the decision at age 62 to carry on working and defer withdrawal, the yearly pension will increase from NOK 170 000 to NOK 239 000 at the age of 67 and NOK 300 000 at the age of 70. The effect of one additional year of work is about 2.5%; the total effect of deferring the withdrawal one year and in addition generating new pension rights through work will typically be about 7.5% (Ministry of Labour, 2009). This improves the incentives to work: under the old system, a full pension was obtained after an insurance period, based on residence, of 40 years, and the 20 best income years counted in calculation of the benefit.

No major changes in the rules pertaining to the public sector

The new old age pension system has improved the incentives to continue working. A major shortcoming, however, is that only about 40% of new pensioners, mainly those working in the private sector, are affected substantially by the new rules so far (Box 3.2). A challenge that lies ahead is to ensure broader coverage of – and application of the new system's principles for – employees in the public sector.

Box 3.2. **The effect of Norway's 2011 pension reform on different groups**

- Disabled (41%)
  - Moved to the old age pension at the age of 67, with half of the ordinary life-expectancy adjustment.
- Employees in the public sector (19%)
  - The former early retirement scheme for ages 62 to 66 is maintained.
  - Occupational pension from age 67 is included to some degree in the actuarial system.
- Employees in the private sector – collective agreement (16%)
  - Entitlements from the public pension system and collectively agreed supplementary AFP are included in the actuarial system.
- Employees in the private sector – no collective agreement (24%)
  - The self-employed and people with no or low labour incomes are included.

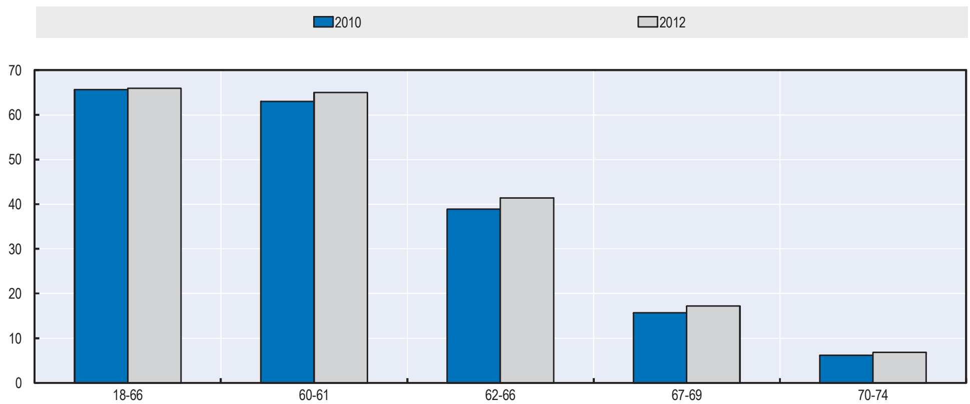
Source: Statistics Norway.

Key trends

The employment rate of people above the age of 60, and particularly in the age group 62-66, has increased after the implementation of the reform, while the total employment rate of the age group 18-66 has been stable over the same period (Figure 3.3).

Figure 3.3. **Employment rates by age group, Norway, 2010 Q2 and 2012 Q2**[a]

As a percentage of the population in each group



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a) The self-employed are not included.

Source: Norwegian Labour and Welfare Administration (NAV).

In spite of these increases in the employment rates of older workers, it is too early to draw any conclusions about the effects of the 2011 pension reform. Employment rates have been slowly increasing beyond the age of 55 over the past decade – particularly for the 60-64 age group, as indicated in Chapter 2. Factors that are important in explaining this trend are higher employment rates among new cohorts of older women, and an increased average level of education in the older age groups (Ministry of Labour, 2012).

Employment rates have increased among older workers both in the private and public sectors, even if public sector employees are only modestly affected by the 2011 pension reform. From 2010 to 2011, for the 60-74 age group, the share of employees remaining in work has increased by 1.9 percentage points in the public sector and by 3.2 percentage points in the private sector. The increase was considerable for ages 61 and 62 in both sectors. In the private sector, the share remaining in work increased by 7.8 and 5.8 percentage points for ages 61 and 62, respectively.

64.3% of retirees in the 62-66 age group combined the old age pension with work in 2011. The self-employed are not included, so the real numbers are probably somewhat higher. The share of recipients combining pensions with work was higher for women than for men (71.1% and 62.8%, respectively). The share decreases with age for both genders.

Dahl and Lien (2011) indicate that 69% of those taking up flexible old age pensions in the second quarter of 2011 were registered as working six months earlier. Adjusted for this, about 90% of recipients of the new flexible old age pension who actually were working until pension take-up, stayed on working. Employment rates are only marginally higher for those of the same age not taking up their pension.

The old age pensioners aged between 62 and 66 continue working almost as much as they did prior to taking up their pension benefits. The average number of hours worked per week was 34.2 for those receiving a pension benefit, only 1.3 hours less than before beginning to receive the pension. Of those combining work and the old age pension, over 80% work at least 30 hours per week.

A difficult choice

Taxation must be taken into account to decide the optimal withdrawal age. People who receive a full old age pension or a public sector AFP of NOK 165 000 or less can in 2012 receive a special tax credit up to a maximum of NOK 29 300. The tax credit is reduced for partial pensions and with increasing pension income. There are no tax credits for pensions above NOK 518 950. The special tax credit is independent of labour income.

Receiving a full pension of a lower yearly amount over a longer period can offer greater tax relief than other take-up patterns; here, partial and deferred pensions are less attractive. It is, however, difficult to assess the full value of the tax credit, since interaction with other progressive elements in the tax system may reduce the value of the credit. A more neutral taxation would make it easier for individuals to make choices that support the objectives of the reform.

The total effect of indexation rules, life-expectancy adjustment and taxation is complex, and surveys show that many individuals have problems ascertaining what is best for them economically. Information must be accessible through channels used by broad groups of the population if it is to reach people who are not actively seeking it, including younger people.

Several tools are available in Norway for pension calculations and financial advice. *Finansportalen.no* is a web service provided by the Norwegian Consumer Council, and certified as meeting the OECD's criteria.[1] The portal is a tool to help consumers compare the different products offered by the financial services industry. The existing pension portals in Norway, already accessible via *Finansportalen*, would be a good basis for development of a more coherent framework, which could also cover taxation.

Sustainability must be monitored

The new system for accrual of pension rights, introducing a tighter connection between those rights and lifetime income, will be phased in gradually. Because of transition rules, the new system will be fully applied only for individuals born in 1963 and after. Life expectancy is increasing, and consequently life-expectancy adjustments of pensions mean that people must work longer – and therefore postpone taking up the pension – in order to receive the same yearly pension payment as before.

These adjustments can be seen as a substitute for increases in the pension age (Chomik and Whitehouse, 2010). The idea is that people will voluntarily work longer as life expectancy increases, to make up for the lower yearly pension payments. So far the evidence of the life-expectancy adjustment is limited, and it is too early to say if the effect on work participation of this sustainability mechanism is strong enough, or if further actions are needed to postpone retirement.

Based on the impacts of previous changes in the legislation concerning combinations of work income and pensions for those older than 67, Brinch, Hernæs and Zhiyang (2012) argue that it is unrealistic to expect large labour supply effects from future pension rights, but that there should be a large amount of early pension take-up and a large labour supply effect from flexible pension take-up. Other measures could then be needed to reduce exit through health-related benefits and to encourage groups with low work participation – for instance women in part-time jobs – to increase their working hours.

Public pensions in Norway are financed by tax revenues on a pay-as-you-go basis. The sustainability of public finances is evaluated as part of *Long-term Perspectives for the Norwegian Economy 2013* (Ministry of Finance, 2013a). Given the present tax level and welfare system, population ageing will create a gradually increasing gap between public revenues and expenditures if the labour supply remains unchanged. In 2060, this financing gap is estimated at 6% of GDP in the mainland economy.

Fredriksen and Stølen (2011) analysed the potential effects of the pension reform by looking at the ratio of expenditures to old-age pension and tax revenues, which they estimate to increase from 10.4% in 2010 to 15.6% by 2050. In the pre-2011 pension system, the ratio was estimated to increase to 19.7% by 2050. The Labour Ministry has given the Norwegian Research Council a mandate to evaluate the 2011 pension reform over the period 2011-18. If the estimated effects are achieved will depend on a number of factors, including the effects of the “second-pillar schemes”.

High take-up of an early pension combined with work suggests a large labour supply potential after age 62, and that the minimum retirement age could become an issue in discussions of further initiatives to strengthen sustainability. Midtsundstad and Bogen (2013) point out that the minimum retirement age of 62 was not really discussed as part of the pension reform. Brunborg (2013) concludes that the only factor that may significantly affect the future ratio of the working and non-working population is longer working lives. He projects that this ratio will remain at the current level if the pension age is increased from 67 years to 78 years by the end of the century.

Options for mobility and early retirement

Contractual Early Retirement (AFP) in the private sector

About two-thirds of employees in the private sector are covered by the Contractual Early Retirement scheme (AFP) from the age of 62, whose origin goes back to the 1988 wage settlements. The scheme is a part of the so-called second pillar, which in Norway includes both AFP and occupational schemes.

The AFP pension in the old scheme (pre-2011) was calculated on the basis of the retiree's earnings history and a projection of the income the individual would have made had they worked until the former pension age (67) in the national insurance scheme. The AFP terminated at the age of 67 and was then replaced by the old age pension. Combinations of work income and AFP above a low income threshold reduced the AFP in proportion to the gained income.

As part of wage settlements in the private sector, the AFP for those aged 62-66 is changed in line with the changes in the public old age pension system (Box 3.3). From 2011, the AFP scheme in the private sector provides a supplement to the public old age pension, and can now be combined with work income, without any income test.

Trends in take-up

Because the old scheme is phased out gradually over a period until the end of 2015, a large number of recipients are still covered by the old scheme. According to information from the administrator of the scheme – Fellesordningen for AFP – the number of recipients in the new scheme had increased to almost 20 000 by the end of 2012. It was estimated that a similar number of eligible people deferred their AFP pension.

Box 3.3. **Contractual Early Retirement (AFP) in the private sector**

The earliest take-up age is 62. The yearly payment will increase if take-up is deferred until the age of 70. AFP in the private sector can be combined with work income, without any reduction in the pension.

Employees are entitled to AFP in the private sector if, until take-up of the benefit, they work in an enterprise that has the scheme as a part of its collective agreement. They must meet certain criteria regarding membership in the scheme and accrued rights in the national insurance scheme. As a main rule, the employee must have been a member of the scheme at least seven out of the last nine years before reaching age 62. In addition, eligibility depends on receipt or previous receipt of an old age pension from the national insurance scheme. There are less strict rules for persons born before 1955.

The yearly AFP is calculated at 0.314% of all pensionable income in the years up to and including the year in which one reaches age 61. All incomes up to a ceiling of 7.1 the base amounts (in 2012, NOK 576 186) are included. The supplement typically amounts to a supplement to the public old age scheme of slightly above 20% for the entire remaining lifetime. There is no gradual benefit.

The AFP is adjusted for life expectancy. The benefit cannot be combined with disability benefits or survivor's benefit.

The new scheme includes people born in 1948 or after, and who are entitled to AFP later than 1 January 2011. People born between 1944 and 1947 can be entitled to the new AFP, according to transition rules, as long as they have not taken up AFP from the old scheme.

Source: Ministry of Labour, Norway.

About 75% of the 20 000 who have their AFP from the new scheme, combined work income and private sector AFP by the end of June 2012. The share of people in the age group 62-66 who stopped working the preceding 12 months fell from 23% after the second quarter of 2011 to 15% one year later. So far, the new AFP in the private sector seems to have developed satisfactorily in accordance with the intention of the pension reform, by increasing flexibility and incentives to combine work and pension. It is, however, not possible yet to conclude how much of the increased combination of work income and AFP is due to the reform as distinct from the relatively tight labour market, considering that there are labour shortages in some sectors and occupations.

Eligibility criteria and reduced mobility

The different AFP schemes for employees in the private and public sectors are a major structural barrier in the Norwegian labour market (OECD, 2012). The requirement of a certain service period before the age of

62 in order to be entitled to an AFP pension in the private sector means that newcomers above the age of 55 would not be eligible. In addition to reducing individual job mobility, this rule will hinder mobility between the private and public sectors. It is important to ensure that employees who transfer between the public and private schemes do not have their pension entitlements revoked. Rules preventing loss of pension rights for people who change jobs across sectors would improve transparency and support mobility, which can be important in the later phase of a career.

Contractual Early Retirement (AFP) in the public sector

In the public sector, which accounts for about one-third of all employment in Norway, the old AFP system is still in place as a separate early retirement scheme for the 62-66 age group (Box 3.4). The annual pension is mostly independent of the retirement age for that group. AFP pensions are proportionally reduced if the recipient is still working, and AFP cannot be combined with the public old age pension; this creates a very high "implicit tax" on continued employment and a strong incentive to retire early.

Box 3.4. **Contractual Early Retirement (AFP) in the public sector**

A public sector worker is entitled to AFP if he or she works in a public enterprise or institution where AFP is included in the collective agreement. The benefit can be received from the age of 62 and if the special requirements regarding income, work relations, membership and accrual of pension rights in the national insurance scheme are met. The main condition is a ten-year minimum vesting period in the public old age pension scheme after the age of 50.

The employee must be working until take-up of the AFP. After take-up, the AFP benefit is reduced in proportion to the work income. AFP in the public sector cannot be combined with an old age pension from the national scheme, disability benefits, a survivor's pension or a work assessment allowance.

The benefit is calculated as the old age pension for a person working until the age of 67, without any life-expectancy adjustment, and there is an added supplement of NOK 1 700 per month. At the age of 65, the benefit may be calculated in the same manner as the occupational pension.

Source: Ministry of Labour, Norway.

From the end of 2011 to the end of 2012, the share of recipients receiving the public sector AFP declined by 0.8 percentage points. About 25 400 persons received AFP in the public sector by the end of 2012.

Work incentives in the public sector relatively unchanged

The result of the present situation is that incentives to continue work have not changed much for employees in the public sector. A surprisingly high take-up of the old age pension by employees in the 62-66 age group may indicate that they are interested in more flexibility, as in the private sector. The overwhelming majority (90.7%) of the employees in the public sector taking up a flexible old age pension were still working by the end of 2011.

Simulations done by Statistics Norway show that in the short run, the schemes for AFP and occupational pensions in the public sector will not have any significant effect on the labour force (Fredriksen and Stølen, 2011). In the long run, the lack of alignment of the public sector schemes to the new flexible old age pension will, however, significantly reduce the pension reform's contribution to the labour force. According to their simulations, the labour force in 2025 would increase by about 25 000 persons if the public sector introduced an AFP and occupational system providing the same incentives as in the private sector. In 2060, labour force loss is projected to increase to about 80 000 persons on the grounds of lower incentives. Without any alignment, the effect on the labour force of the 2011 pension reform is estimated to be only three-quarters of the original estimate of a 240 000-person (7%) increase.

Negotiations between public sector employers and unions should therefore seek to reform the public sector scheme so as to fully align it with the principles of the reformed private sector system. This would support higher job mobility in society by facilitating job changes across sectors without loss of AFP rights. At the individual level, a more transparent system with better incentives to continue working after the age of 62 will facilitate planning of work-retirement choices beyond the age of 67.

Occupational pension schemes

Occupational pensions in the private sector

Mandatory occupational schemes were introduced in the private sector in 2006. Previously, implementation of an occupational scheme was a voluntary decision on the part of the firm. The schemes could be either defined-contribution or defined-benefit schemes. Over time, there has been a transition from the latter to the former. Before the 2011 pension reform, the earliest take-up age in the occupational scheme was, as a main rule, 67.

Both the defined-benefit and defined-contribution occupational pension schemes have been aligned with the new public old age pension, to match the take-up flexibility offered. It is now possible to receive benefits from the occupational scheme from the age of 62, and it is possible to combine those benefits with work without any reductions in the benefits – that is, there is no earnings test. In the defined-benefit schemes, pensions are adjusted for the time of withdrawal, so that deferring receipt will increase the benefits.

Further reforms in progress

Further regulatory work has begun on adapting defined-benefit occupational pensions to the principles of the new public pension system. A commission report (Ministry of Finance, 2012) was presented to the Norwegian Minister of Finance in June 2012, after which the ministry held a public consultation. The models proposed are built on the same principles for pension earning as the reformed public old age pension and the new private sector AFP scheme, where all years of income are accounted for. This will contribute to more transparency and make it easier for employees to understand all of the information concerning the different schemes. Complicated transition rules can, however, delay achievement of the positive effects (Ministry of Finance, 2013b), and are an argument for a rapid phase-in of the new legislation. Good information services through, for example, public web services will also help.

In the future: one single second pillar?

As a result of the changed AFP scheme, employees in many private sector firms are in fact members of two more or less parallel second-pillar schemes, but with different rules and regulations. For employees with an AFP pension but only minimum occupational pensions, the AFP will provide the largest supplement by far to the public old age pension (Hippe and Lillevold, 2010; Christensen et al., 2012). There are arguments in favour of merging the two second-pillar elements and adapting AFP to the framework of the occupational schemes. Simplifications are possible, and total pension benefits and costs will be more transparent. Studies show that with a good defined-benefit scheme and a lifelong AFP on the top of the public old age pension, the replacement rate may in some cases be close to 100%.

Occupational schemes in the public sector

The old occupational pension system in the public sector, based on the final wage, is still in place, excepting introduction of the life-expectancy adjustment and the same indexations as in the public old age scheme. Persons born before 1959 are, however, guaranteed that the sum of the pension from the occupational scheme and the national old age pension will be 66% of the final wage after life-expectancy adjustment. For persons born in 1959 and later, the rules are not yet legislated. The occupational pension can be drawn beginning at age 67. A full occupational pension is attained after 30 years of service if the employee works in the public sector at retirement, while 40 years of service are required if the employees leave the public sector prior to retirement. Contrary to the private sector, working beyond the point where the increase in life expectancy is compensated does not result in higher pension benefits for employees in the public sector.

As suggested earlier, different schemes and vesting rules may have considerable effects on the pension payments as a consequence of job changes between the public and the private sectors. The complexity of the current situation is, however, hard to navigate through, and studies are inconclusive with respect to the effects of occupational pensions on mobility. Hernæs et al. (2011), for instance, find little effect of occupational pensions on job mobility. However, the relatively few job changes among older workers in Norway highlighted above, as well as a tendency to move within segments of the labour market, must be taken into account.

Proposals for future reforms

A system that provides a pension as a share of the final wage is not readily adaptable to new principles based on lifelong pension earning, flexibility and life-expectancy adjustment. Reform of the public sector occupational scheme based on a principle of pension earning of yearly incomes will make it possible to develop a more transparent and understandable pension system, particularly for those who have their career in both the private and public sectors. Private and public sector schemes should to the extent possible be based on common principles for vesting and withdrawal, supporting mobility between the two sectors without the threat of lost pension rights.

Disability benefits as a pathway to early exit

Key trends

Detailed analysis of exit from the labour market reveals large differences across countries (OECD, 2011). A special feature of the Norwegian labour market is that exit through unemployment benefit is low compared with most other countries but exit through disability benefit is high – even with disability rates decreasing somewhat over the past decade (Table 3.1). By the end of 2011, 19.7% of the 55-59 age group and 30.4% of the 60-64 age group received disability benefits. The share of disabled people is particularly high for older women: 23.5% in the age group 55-59 and 35.7% in the age group 60-64.

Table 3.1. **Disability benefit recipiency rates by gender, Norway, 2000-11**

As a percentage of the population in each group

		2000	2005	2010	2011
Total	50-54	14.7	13.7	12.2	12.4
	55-59	21.7	22.2	19.6	19.7
	60-64	35.5	33.6	31.8	30.4
	50-64	22.3	22.4	20.9	20.5
Women	50-54	18.2	16.5	14.4	14.9
	55-59	25.9	26.7	23.5	23.5
	60-64	39.6	38.3	37.1	35.7
	50-64	26.3	26.4	24.7	24.3
Men	50-54	11.4	11.0	10.1	10.1
	55-59	17.4	17.9	15.8	15.9
	60-64	31.3	28.8	26.6	25.2
	50-64	18.3	18.5	17.2	16.8

StatLink http://dx.doi.org/10.1787/888932814694

Source: OECD estimates based on Statistics Norway data.

After age 50, inflows to disability benefits in 2011 were above average in industries such as transportation, retail trade, accommodation and food service, professional, scientific and technical services, and health and social work activities. After age 60, inflows from manufacturing industries and the construction sector were also above average. Geographical variations in disability rates are well documented. Bragstad and Hauge (2008) found that geographical differences are, to a large extent, related to age structure, employment, unemployment and industry composition.

Overall in 2011, 82% of the recipients of disability pension were on a full pension. This share is higher for men than for women. After the 2011 pension reform, those who receive a partial disability pension may take out a partial old age pension, but the sum of the two parts cannot exceed a full pension – i.e. a 50% disability can be combined with a maximum of 50% old age pension. In December 2011, 1 555 persons combined an old age pension with a partial disability pension.

Key findings

The "grey area" between disability and unemployment

For Bratsberg and Røed (2011), the increasing number of disabled people in Norway is not explained by ageing. The effect of an ageing population is counteracted by increased education. They conclude that the explanation must be found in the relation between health issues and the labour market. Bratsberg, Fevang and Røed (2010) argue that there is a "grey area" between disability and unemployment, and they claim that the risk of disability increases with the incidence of unemployment. The increasing numbers of disabled people could indicate that the "real" unemployment rates are higher than the registered rates. Other reasons may be that work requirements are becoming tougher, or changes in social norms and attitudes to disability. Rege, Telle and Votruba (2009) and Bratsberg, Fevang and Røed (2010) looked into the effect of firm closures and downsizing on the probability of claiming disability benefits. Both studies found a positive correlation between firm closures and downsizing and rising inflows to disability benefits.

Increased longevity means that care of elderly parents is becoming more of an issue. This has raised questions about the burden for women, and possible effects on work capacity, employment and early retirement. Kotsadam and Jakobsson (2012) find that care for elderly parents has an effect on women's labour force participation in European countries, but that that effect is small in Norway and cannot be used as an explanation for the higher incidence of disability among older women.

Social benefits – a broad way out for older workers

Outflows from the disability benefit scheme to work are very low, as is the rejection rate of claims for disability benefits. The share of older recipients of the previous temporary disability benefit was low. OECD (2013) observes in a review of mental health and work that the older the disability beneficiary, the milder is the mental disorder. That finding suggests that there should be more temporary benefits relating to the older age groups. While developmental and early childhood disorders may often be indeed permanent and disabling, it is far from obvious why more moderate neurotic or (e.g.) depressive disorders – that mostly start later in life and do not prevent establishing oneself in the labour market – should have such permanent disabling effects. The recommendation to block the exclusion perspective as early as possible by developing a rapid basic decision about eligibility for a permanent disability pension is one way to stimulate and support efforts to come back to work.

Myklebø (2011) analyses re-entry to work among recipients of social benefits. She finds that 66% of the unemployed and 36% of people who had been registered as having reduced work ability were in a job six months after their last registration at the NAV. Re-entry to work is indeed highest among those who had been registered as unemployed. The probability of restarting work was 74% for the 45-59 age group, declining to 57% for people above the age of 60. The likelihood of leaving the labour market once more because of health problems is highest for the 60-66 age group. Among those previously registered as having reduced work ability, 45% of the 60-66 age group were receiving a disability benefit six months later.

A study by Statistics Norway shows that there is a substantial potential among younger disabled people to work if financial incentives are increased (Ravndal Kostøl and Mogstad, 2012). The study does not, however, find any effects of economic incentives among disabled people in the 50-61 age group. One reason could be that younger people have more years ahead in work, so their economic gain will be larger. Another reason could be that disability benefits for older workers may be the last stop in a more complex pathway out of the labour market, often connected to poor working conditions and the local labour market situation. This result is supported by Bråthen (2011). Based on data from the Norwegian labour force survey, he estimates that nearly 32 000 people receiving disability benefits would like to start working. But while 22% of recipients in the 35-49 age group report willingness to work, the share is only 9% among people above the age of 50.

New directions for reform

According to the 2011 legislation, disability pensioners are partly sheltered from the life-expectancy adjustment at the time they are transferred to the old age pension scheme. The reason is that disability pensioners cannot be expected to work longer to compensate for the effect of the life-expectancy adjustment. On the other hand, the result could be increased inflows to disability benefits to escape the effect of the life-expectancy adjustment. It will be important for the Norwegian authorities to monitor this situation closely over the coming years. A review of how disability benefits have adapted in reality to the reform is planned for 2018. This review must take into consideration that the partial sheltering of disability benefits will increase the gap between relatively generous disability benefits and the old age pension considerably, as life expectancy is increasing. Such sheltering is probably not sustainable in the long run.

Disability benefits separated from the old age pension in 2015

A substantial decline in inflows to disability benefits of older and middle-aged people is required to obtain a substantial increase in employment rates of people in the upper age brackets. A proposal to separate disability benefits from old age pensions was amended by Parliament in 2011, in line with recommendations from the OECD. Calculation of the benefit will become more similar to the way temporary health benefits prior to receiving a disability benefit are calculated. This should make the distinction between disability benefits and early retirement benefits clearer. The new disability benefit will also be made more flexible when combined with work income (Box 3.5).

Box 3.5. **The main features of the reformed disability benefit in 2015**

The disability benefit replacement rate for new recipients will be 66% of their previous income. This is somewhat higher than the average replacement rate in the old system. The disability benefit will be taxed as income.

In the present scheme, the disability benefit is calculated in the same manner as the old age pension. The new disability benefit will be calculated on the basis of the income from the best three out of the past five years preceding the onset of disability.

The new scheme will make it easier to combine work and disability benefits, especially for those with varying work ability. It will always pay to work more. The disability benefit will be adjusted when work income increases. The pension will be reduced when the income is higher than 0.4 base amount (over NOK 30 000). For current disability pensioners, this income limit will be NOK 60 000 until 2019.

Transition from the disability benefit to the old age pension will take place at the age of 67. Those covered by the new old age pension of the national insurance scheme will accrue rights to the age of 62.

Disability pensioners will have their old age pension partially exempted from life-expectancy adjustment from 2011. The reduction is 0.2 percentage points per cohort. This is a temporary arrangement that will apply to disability pensioners born between 1944 and 1951, i.e. disability pensioners who will receive an old age pension in the period 2011-18. In light of the monitoring of the disability pensioners’ adaptation to the new provisions in the next few years, it will be considered in 2018 whether, and how, a permanent shielding system should be designed.

The government aims for the rules to enter into force in 2015. The current disability pensioners will be less affected by the reform, although some changes will also apply to them.

Source: Ministry of Labour, Norway.

The amended disability reform does not include any changes in the replacement rates or eligibility criteria. However, based on observations that disability pensioners in the present scheme have to some degree adapted to the maximum work income that can be earned without reassessment of their disability, the reform is considered to have the potential to substantially increase the amount of part-time disability recipiency by facilitating combinations of work income and disability benefits.

Access to part-time jobs

In Norway as well as in many other OECD countries, over the years there has been a trend to promote partial health-related benefits. In Norway and Sweden, partial absence from work accounts for about one-third of the long-term sickness absence. Various studies show that use of partial sickness absence certificates contributes to reduced lengths of absence spells, and improves employment perspectives in subsequent years (see Røed, 2012 for an overview). Participation requirements reduce the leisure component of the insurance. But there is also increasing evidence that work in most cases is good for health and can aid recovery. For example, Black (2008) finds that long-term "worklessness" can have negative health effects.

The focus on the use of partial benefits and the use of remaining work ability is positive. This should not, however, weaken efforts to reduce the inflows to disability benefits as such, or efforts to improve the probability of remaining in full-time jobs. The approach adopted depends greatly on the availability of part-time jobs. So far, much seems to rely on economic incentives for individuals, combined with social responsibility among employers (see Chapters 4 and 5). OECD (2013) discusses the responsibility of employers, and recommends development of a substantial co-financing obligation of the disability costs. More financial responsibility for the employers will increase the incentives of prevention and adaptation of the working conditions, and reduce outflow of the labour market to early retirement and health-related benefits.

Stronger gatekeeping to equalise practice

Geographical differences in receipt of disability benefits may indicate that practices of the criteria for entitlement to disability benefits vary across Norway. The disability assessment process is comprehensive, but rather fragmented (OECD, 2013). Closer interaction among actors in the process could ensure an interdisciplinary assessment of the case. Better tools can also contribute to a more uniform assessment and rehabilitation process. As an example, guidelines to general practitioners to improve gatekeeping related to sickness benefits were implemented in 2011. OECD (2012) has recommended extending a similar system to disability benefits. Feedback on their practice compared with other doctors may give the general practitioners useful information, and could be used to design targeted training programmes. More systematic information about and feedback on practice may also be used to sanction doctors making clearly aberrant decisions.

Combinations of old age pension and other social benefits

Previously, there was a principle that a person could not receive more than one full benefit from the National Insurance System. This was changed in

2011 with the introduction of the flexible old age pension, under which individuals who opt for early pension receive lower yearly payments along with the option to combine work and pension without any earnings test. New legislation entered into force in 2011 that allows combining an old age pension with unemployment benefits or health-related benefits (Box 3.6). The challenge of the approach is to avoid increased use of these benefits as a replacement for or supplement to an old age pension or as a *de facto* exit from the labour market before the age of 62. A reduction of the replacement rate in the case of sickness absence from 100% to around 80%, as recommended by the OECD (2013), could to some extent reduce such incentives.

Box 3.6. **The old age pension in combination with other social benefits**

With sickness benefits

Individuals aged 62 to 67 years can receive sickness benefits for a maximum period of one year in combination with an old-age pension, if they meet the conditions for receiving sickness benefits. Individuals aged 67 to 70 years receiving a labour income of at least two times the base amount (in 2012, NOK 162 306) are entitled to a maximum of 60 days of sickness benefits.

With unemployment benefits

The same rules and conditions for entitlement to unemployment benefits apply to both old age pensioners aged 62 to 67 and younger age groups.

With work assessment allowances

The same rules and conditions for entitlement to work assessment allowances apply to both old-age pensioners aged 62 to 67 and younger age groups.

With disability benefits

A full disability pension cannot be combined with an old age pension. A partial disability pension can be combined with a partial old age pension between the ages of 62 and 67, but the sum of the two partial pensions cannot exceed a full pension.

With a survivor's pension

An old age pension and a survivor's pension cannot be combined.

Source: Ministry of Labour, Norway.

A study based on data on the third quarter of 2011 so far shows no indications that the pension reform had such negative effects (Lien, 2011). Its development is evaluated by comparing inflow rates in the private and public sectors – since the pension system in the public sector is kept relatively unchanged – with small changes in the incentives to take up other benefits. The possibility of combining work income with a pension may reduce the incentives to take up benefits that cannot be combined with work. Still, it is too early to judge. Development should therefore be closely monitored, including sick-listing practices, access to advice and assistance, and fulfillment of mutual obligations.

Key stylised facts

The 2011 pension reform allows flexible retirement between the ages of 62 and 75, and improves incentives to work. The pension benefit is actuarially calculated, with a life-expectancy adjustment an explicit element. Pension and work income can be combined without any financial restrictions, and employment for retirees generates additional pension rights. An obvious shortcoming of the reform, however, is that so far only about 40% of all new pensioners are affected substantially by the new rules. Pensions for disabled people and public sector employees are to a large extent calculated as in the old pension system. The following measures should be considered to further improve incentives to carry on working:

- Second-pillar pension schemes in the public sector should be aligned with the first-pillar.
- The Contractual Early Retirement scheme (AFP) should be consolidated with occupational schemes.
- Stronger gatekeeping to the disability benefit scheme should be introduced in order to reduce inflows.
- The complexity of the reform should be reduced and dissemination of information pertaining to it improved, in order to help older workers make more informed decisions about work and retirement.

Note

1. In March 2008, the OECD launched the International Gateway for Financial Education, *www.financial-education.org/home.html*, which serves as a clearinghouse for financial education programmes, information and research worldwide. At the G20 Leaders’ Summit in Los Cabos, Mexico in 2012, the OECD/INFE High-level Principles on National Strategies for Financial Education were endorsed.

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