Working Group Memorandums of the Ministry of Social Affairs and Health 2002:18eng

Finland's National Pension Strategy Report

Updated version, October 2002

MINISTRY OF SOCIAL AFFAIRS AND HEALTH

Helsinki, Finland, 2002

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Julkaisija Sosiaali- ja terveysministeriö	**Julkaisun päivämäärä** 15.10.2002
Tekijät (toimielimestä: toimielimen nimi, puheenjohtaja, sihteeri) Kansallisen eläkestrategiaraportin laativa työryhmä Puheenjohtaja: Tarmo Pukkila, STM Sihteerit: Tarja Härkönen, STM Antero Kiviniemi, STM Mika Vidlund, ETK	**Julkaisun laji** Työryhmämuistio **Toimeksiantaja** Sosiaali- ja terveysministeriö **Toimielimen asettamispäivä** 15.2.2002

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Tiivistelmä

Työryhmä on toimeksiantonsa mukaisesti laatinut ehdotuksen EU:lle toimitettavaksi kansalliseksi eläkestrategiaraportiksi Laekenin Eurooppa-neuvostossa 14.-15.12.2001 sovitun mukaisesti. Laekenin Eurooppa-neuvostossa sovittiin nk. avoimen koordinaatiomenetelmän soveltamisen sisällöstä ja menettelytavoista eläkkeiden alallla. Ehdotuksessa tarkastellaan Suomen eläkejärjestelmää ja Suomessa tehtyjä eläkepoliittisia ratkaisuja Laekenissa sovittujen 11 yhteisen eläkepoliittisen tavoitteen kannalta. Kunkin tavoitteen osalta tarkastellaan Suomen eläkejärjestelmän nykytilaa, haasteita sekä tehtyjä kehittämislinjauksia.

EU-tasolla yhteisesti sovitut tavoitteet toteutuvat pitkälti nykytilanteessa Suomen eläkejärjestelmässä. Väestörakenteen ikääntymisen asettamiin haasteisiin kyetään vastaamaan jatkamalla eläkejärjestelmän kehittämistä hallitusohjelmassa, työmarkkinajärjestöjen 12.11.2001 ja 5.9.2002 tekemissä sopimuksissa ja SOMERA-toimikunnan 4.4.2002 antamassa mietinnössä tehtyjen linjausten mukaisesti. Erityisenä haasteena on hallita eläkemaksutason kehitys ja turvata asianmukainen eläketaso. Haasteisiin vastattaessa tarvitaan konkreettisia toimenpiteitä erityisesti työllisyysasteen kohottamiseksi ja työurien pidentämiseksi. Tässä suhteessa työelämän kehittäminen ja vakaa talouskehitys ovat keskeisessä asemassa.

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Arbetsgruppen har enligt uppdrag sammanställt ett förslag om en nationell pensionsstrategirapport som skall överlämnas till EU enligt det som avtalades vid Europeiska rådets möte i Laeken 14-15.12.2001. Vid Europeiska rådets möte i Laeken ingicks avtal om innehållet och förfaringssätt i tillämpningen av den s.k. öppna samordningssmetoden på pensionsområdet. I förslaget granskas Finlands pensionssystem och pensionspolitiska lösningar som gjorts i Finland med de 11 gemensamma pensionspolitiska målen som avtalats i Laeken som utgångspunkt. För varje mål granskas Finlands pensionssystems nuvarande läge, utmaningar samt utvecklingsutstakningar.

Målsättningarna som gemensamt överenskommits på EU-nivå förverkligas för närvarande långt i Finlands pensionssystem. Utmaningarna som framförs av att befolkningsstrukturen åldras kan mötas genom att föra vidare utvecklingen av pensionssystemet enligt de utstakningar som gjorts i regeringsprogrammet, avtalen som ingicks av arbetsmarknadsorganisationerna 12.11.2001 och 5.9.2002 och i betänkandet som gavs 4.4.2002 av SOMERA-kommissionen. En särskild utmaning är att behärska utvecklingen av pensionsavgiftsnivån och trygga en lämplig pensionsnivå. Då utmaningarna möts behövs konkreta åtgärder speciellt för att höja sysselsättnings-graden och förlänga arbetsbanor. I detta avseende är arbetslivets utveckling och en säker ekonomisk utveckling i ett centralt läge.

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EU, finansiering, pensioner, sysselsättning, socialskydd, åldrande

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Summary

In accordance with its terms of reference the Working Group has prepared a proposal for a National Pension Strategy Report to be submitted to the EU, as agreed in the Leaken European Council on 14 - 15 December 2001. The Leaken European Council agreed on the content and procedures in the application of the open co-ordination method in the field of pensions. The proposal reviews the Finnish pension schemes and the pension policy decisions taken in Finland from the perspective of the eleven common pension policy objectives agreed in Laeken. The present state of the Finnish pension system, its challenges and the development plans made for it are dealt with relative to each objective.

The objectives agreed jointly at the EU level are largely implemented in the present Finnish pension system. The challenges posed by the ageing demographic structure can be met by continuing to develop the pension schemes in accordance with the policy lines outlined in the Government programme, the agreements concluded by the labour market organisations on 12 November 2001 and 5 September 2002 and in the report of the so called SOMERA Commission of 4 April 2002. A special challenge is to keep the development of the level of pension contributions in check and to ensure an appropriate pension level. Concrete measures are needed to address these challenges in particular in order to increase the rate of employment and lengthen people's work careers. In this respect the focus is on the development of working life and stable economic development.

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To the Ministry of Social Affairs and Health

The Ministry of Social Affairs and Health appointed on 15 February 2002 a working group to prepare Finland's National Pension Strategy Report as agreed at the Laeken European Council

The Laeken European Council agreed on the content and procedures in the application of the open co-ordination method in the field of pensions. The introduction of the open co-ordination method involves agreement on the eleven common pension policy objectives at the Community level, their inclusion in the national pension strategies, and regular monitoring of the attainment of the objectives at the EU level. The common objectives are based on the three principles concerning pension policy that were adopted at the Gothenburg European Council in June 2001, comprising adequacy of pensions, financial sustainability of pension systems, and modernisation of pension systems in response to the changing needs of the economy, society and individuals.

When preparing the national pension strategy the Working Group should:
- take into account the common objectives agreed at the EU level, outline corresponding national objectives, assess the current situation of the Finnish pension system in relation to the common objectives and to present the measures – including the implemented or decided measures – that are necessary to attain those objectives;
- monitor and take into account the ongoing work to develop indicators for measuring the common objectives;
- arrange bilateral seminars with the Commission; and
- co-operate with the Social Protection Committee, the Economic Policy Committee, the Committee on Employment and Social Affairs, and the Commission.

The Working Group should take into account any studies, surveys and working group reports that are available on the theme. If necessary, the Working Group should commission further studies on the issue.

The composition of the working group is as follows:

Chairman:
Pukkila Tarmo, Director-General, Ministry of Social Affairs and Health

Members:
Haikarainen Tuulikki, Deputy Director-General, Ministry of Social Affairs and Health
Koivuneva Eeva-Liisa, Senior Officer for Legal Affairs, Ministry of Labour
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Rauhamaa Elisa, Head od Pension Administration, Association of Pension Foundations, Osuuspankkien eläkesäätiö

Äimälä Markus, Senior Legal Adviser, Confederation of Finnish Industry and Employers

The secretaries of the Working Group have been Senior Officers Tarja Härkönen and Antero Kiviniemi, both of the Ministry of Social Affairs and Health, and Researcher Mika Vidlund of the Central Pension Security Institute.

The main representative of the Ministry of Labour has been Matti Sihto, Labour Market Counsellor. Senior Officer Silja Romo succeeded Eeva-Liisa Koivuneva as the deputy member of the Ministry of Labour. Timo Silvola, Head of Personal Insurance, succeeded Kaisa Kausto from May 2002 as the representative of the Federation of Finnish Insurance Companies. Director-General Kari Välimäki being prevented his deputy has been Ministerial Adviser Marja-Liisa Parjanne.

As permanent experts for the Working Group were appointed Ministerial Adviser Ismo Suksi and Senior Financial Officer Tiina Heino of the Ministry of Social Affairs and Health, and Ecclesiastical Councellor Leena Rantanen from the Church House.

The Working Group held six meetings during the period from 18 February to 7 June 2002. It will continue its work up to 31 December 2002 in order to take part in the discussion regarding the National Pension Strategy Report in the EU.

The Working Group met representatives of the European Commission in Helsinki on 5 April 2002 to discuss the report and EU co-operation on pensions. The delegation of the Commission was led by Director-General Odile Quintin. The meeting was attended by 75 persons, including representatives of the Goverment and Parliament, as well as of Finnish pension institutions, social security institutions, research institutions, insurance institutions and several associations.

The Working Group hereby respectfully submits its report to the Ministry of Social Affairs and Health.

Helsinki, 27 June 2002

Tarmo Pukkila

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Introduction

The main objective of the Finnish pension system is to ensure that the population resident in the country is covered against the economic risks caused by population ageing, disability, death of a family provider, and long-term unemployment of older persons. The mandatory statutory pension provision comprises an earnings-related pension scheme and a national pension scheme. The earnings-related pension scheme provides earnings-adjusted and insurance-based pensions ensuring to a reasonable degree the earlier consumption potential for all wage-earners and self-employed persons after retirement, and the national pension scheme provides for the whole population a residence-based minimum pension complementing it on the basis of a certain co-ordination mechanism (see Target 1). These two pensions together form the total statutory pension of a pensioner. The statutory pension provision can be complemented with voluntary pension arrangements. (See the survey at the end of report.)

The future challenges facing the Finnish pension system are linked, above all, to the interrelated phenomena of population ageing, increased life expectancy and low fertility rate (see Figures 0.1, 0.2 and 0.3). There is an urgent need to continue the efforts to respond to the challenges of ageing, since the Finnish population will continue to age at a rapid pace up to 2020. It is problematic that the average age of effective retirement from the labour market is 59 years, despite the statutory pensionable age of 65. The economic dependency ratio is anticipated to rise after the year 2015 from the present almost 120 per cent to 140 per cent by 2030 (see Figure 0.4).

At present the ratio of pension expenditure to GDP is about 11 per cent and it is expected to rise to almost 16 per cent by around 2030 (see Figure 0.5). In order to ensure the adequacy of pensions and their financial basis and to curb the pressure to raise pension contributions it is necessary to implement at a rapid pace the pension policy measures founded on employment, economic and education policy decisions that were initiated in the ’90s, as well as the designed reform of the pension system. The internationalisation of the Finnish policy environment, in particular the increasing dependency on international economic developments and migration flows, affect the national decision-making concerning pensions.

In the Finnish pension system the prerequisites for responding to the challenges posed by the demographic structure are favourable. Finland’s public economy shows a surplus and the employment rate has improved much since the depression years of the early 1990s. Furthermore, Finland has undertaken measures to encourage people to continue longer in working life, to maintain employees’ work ability and to develop working life. It has also been agreed that the possibilities to raise the rate of pension prefunding on a temporary basis will be investigated. The pension system also efficiently prevents poverty, since only a small proportion of the elderly population are poor.

* * *

The programme of Prime Minister Paavo Lipponen’s second Government, appointed in 1999, states about pension policy as follows:

> *“Changes will be introduced in working life, measures to maintain the capacity to work and educational policy as well in the pension and the unemployment security system that will encourage employers to retain in their service and recruit also older employees. These changes will be designed to keep older employees in work and in the labour market. The aim is to increase the share of those in work among the*

working population and to extend in the long term the average age of leaving the labour market by about 2 - 3 years to be closer to the normal age of retirement and thus reduce the pressures to increase pension premiums.

”Measures will be agreed with the social partners with the aim of promoting the skills of the working population, its ability to cope with work as well as its general well-being. Efforts will be made to develop voluntary vocational adult education once the relevant studies have been prepared. Measures will be supported to reveal the threat of early loss of working ability and to start rehabilitation measures. Cupertino between the labour administration, the health service and the pension institutes will be initiated to steer those in need of rehabilitation to an effective rehabilitation programme as early as possible.

”Studies will be carried out to simplify the legislation governing employment pensions, the accrual of an employment pension for those under 23 years of age, the addition of the parents' allowance and care allowance period in the pension growth percentage, the need to develop the index-related system as well as preparing for an increase in the average lifespan of the population.

The development of social insurance legislation will be continued in close co-operation with the social partners. ”

The social partners concluded on 12 November 2002 a specific agreement (below: pension agreement) to implement the objectives put forward by the Government. In it the partners agreed on certain adjustments to the earnings-related pensions of private sectors in order to defer the average pension age by 2 to 3 years and to adapt the pension schemes to the increasing average life expectancy. According to the agreement, the labour market central organisations will make every possible effort to support the coping at work and the permanence of employment contracts, in particular in respect of the ageing labour force.

The Government approved the agreement and said in its statement of 13 November 2001 as follows:

… The agreement-in-principle complies with the Government’s objectives to develop earnings-related pensions so as to support remaining in work, work ability and employment and to develop the principle of income-relatedness in accordance with the legislation on earnings-related pensions in the early retirement pension scheme. ... The Government will undertake to prepare earnings-related pension legislation for private sectors on the basis of these proposals and hasten the start of similar negotiations to develop the earnings-related pensions of the public sector.

The broad-based SOMERA Committee set up by the Ministry of Social Affairs and Health submitted its report on the development of social spending and ensuring the financing of social security expenditure in the long term on 4 April 2002. The Committee stated that the principle in responding to the challenges posed by the ageing development must be to improve systematically people’s working and functional capacity, to lengthen the lifetime working time, to curb the pressures to raise pension contributions, to increase the co-ordination of the various forms of social security, to emphasise the features enhancing people’s own activeness and initiative in social security, and to reform the ways of financing and operation of social welfare and health care. According to the Committee the implementation of these principles presupposes that people enter worklife earlier than at present, continue longer in working life, a higher rate of employment and that older people, owing to their improved functional capacity, will need care services at a later stage than at present. The starting point for pension reforms must be to retain the Nordic welfare model and the comprehensive and adequate level of social security.

* * *

Pension policy is an issue that falls under national authority. This report reviews the national pension system and the pension decisions made in Finland, as well as the justifications for them and the employment and economic policy related motives for them, from the perspective of the eleven common objectives agreed at the Laeken European Council on 14 –15 December 2001. The common objectives as a rule correspond to the decisions made in Finland's national pension policy. The matters reviewed in the context of each objective include (1) the current situation, (2) challenges, and (3) the outlined development strategies. The report contains statistics and graphical charts linked to each objective (Appendix 1). The jointly agreed objectives however overlap in many respects, and thus this report contains repetition and internal references.

The report has been drawn up by an ad hoc working group appointed by the Ministry of Social Affairs and Health. Its members represent the Ministry of Social Affairs and Health, Ministry of Labour, Ministry of Finance, Insurance Supervisiory Authority, Confederation of Unions for Academic Professionals AKAVA, Central Union of Agricultural Producers and Forest Owners MTK, Central Organisation of Finnish Trade Unions SAK, Finnish Confederation of Salaried Employees STTK, Employers' Confederation of Service Sector Industries PT, Confederation of Finnish Industry and Employers, Social Insurance Institution, Local Government Pensions Institution, Central Pension Security Institute, Finnish Pension Alliance TELA, Association of Pension Foundations, Federation of Finnish Insurance Companies, Federation of Finnish Enterprises and Association of Insurance Funds.

The composition of the working corresponds to the procedural recommendations issued by the EU for the preparation of the report. Finland has also traditionally developed the earnings-related pension insurance according to the tripartite principle, i.e. in co-operation of the Government and labour market organisations.

The common objectives agreed at the EU level are largely implemented in the present Finnish pension system. The challenges posed by the population ageing can be met by developing the basic structures of the system. In accordance with the basic guidelines defined for the Finnish pension policy and its strategic objectives concrete measures are needed in particular to increase the employment rate and prolong people's working careers. In this respect the measures related to the development of working life and stable and balanced economic development play a major role.

* * *

Complement to the original version of the report

After the completion of the National Pension Strategy Report the Government of Finland has submitted to Parliament several bills with a view to adjusting the Finnish pension system to the ageing of the population, as agreed in the context of the pension agreement of 2001. Furthermore, the labour market organisations signed on 5 September 2002 an agreement which complements and specifies the earlier guidelines for developing the private sector earnings-related pension scheme. The Government will introduce to Parliament a bill concerning these adjustments in October 2002.

Since the bills concerned, once adopted, substantially reform the Finnish pension system, an account of their content is attached at the end of this report under title "Government bills given after submission to the Government of the report dealing with the development of the private sector earnings-related pension scheme, and the agreement of 5 September 2002".

Adequacy of pensions – implementation of social objectives

Target 1 : Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate in public, social and cultural life.

THE CURRENT SITUATION

In Finland the earnings-related and national pension schemes form the mandatory statutory pension provision. The purpose of the statutory earnings-related pension is to guarantee that the consumption potential attained during working life participation is maintained to a reasonable degree after retirement. As a rule, pension accrues from all employment. The statutory earnings-related pension covers all wage and salary earners and self-employed persons. The amount of a pension is influenced by e.g. the earned income, the length of the period of service or self-employment, the pension accrual percentage and the index security applied to the income that the pension is based on and to the payable pension. An old age pension starts to accrue from the age of 23, it accrues mainly at the rate of 1.5 per cent per year of employment and for 40 years at the most. The pension may be at the most 60 per cent of the highest pay on the basis of which the pension is determined.

An earnings-related pension is complemented by residence-based national pension, the purpose of which is to guarantee minimum income for all pensioners. The amount of a national pension depends on the pensioner's earnings-related pension income, family relations and place of residence. A full national pension is granted on the basis of 40 years' residence. In local authority category I a full national pension for a single person is € 487.60 per month, which is about 24 per cent of the average earnings, and in local authority category II € 467.32 per month. For spouses the amounts are € 429.02 and € 411.75 respectively. As a rule, the amount of the national pension decreases as the person's other pension income increases. If the other pensions exceed a certain limit no national pension is paid. In 2001, 55 per cent of all pensioners received a national pension and a full national pension was paid to roughly 10 per cent.

At the end of 2000 the average own pension of an old-age pensioner, which did not include a survivor's pension payable after the death of spouse, was about € 870 per month (gross), i.e. about 43 per cent of the average earnings. The average total pension for old-age pensioners (incl. survivors' pensions) was approximately € 962 per month, about 47 per cent of the average earnings for wage earners.

National pensions and earnings-related pensions are taxable income. Owing to the pension income deduction granted in income taxation no tax is collected for pension income equivalent to a full national pension, however. The pension income tax deduction lightens the taxation of pensioners on small incomes. All taxable earned income and pensions reduce the amount of the pension income deduction. The deduction is granted until the income exceeds a certain limit (see Table 1.1.)

A pensioner can also be paid housing allowance, pensioner's care allowance and child increases. Those who served in the Finnish wars or under war-like circumstances are in addition entitled to front-veterans' supplement and extra front-veterans' supplement. Risks of exclusion are addressed, besides by social income transfers, by public social welfare and health care services accessible to all population groups. Pensioners' participation in public, social and cultural life is also supported, by e.g. reduced fees for public transportation and cultural events.

The value of pensions is maintained by their indexation. National pensions are adjusted yearly by a national pension index that follows the change in consumer prices. Two different indexes are applied to earnings-related pensions. The index for persons of pensionable age (65 years and over) is determined on the basis of the change in price and wage levels so that 80 per cent is determined on the basis of the change in consumer prices and 20 per cent on the basis of the change in the earnings level. This index is used for adjusting the amounts of pensions for people of pensionable age. In the index for working-age people (under 65 years) the changes in the earnings level and prices are of equal weighting. The index for working-age people is used in the calculation of pensionable earnings, in the adjustment of the value of the earned pension rights and in the adjustment of the pensions being paid to people aged under 65 years.

Due to the national pension index the level of the pension provision of national pension recipients has developed at a slower pace than that of the recipients of earnings-related pensions (see Figures 1.1–1.2). On the other hand, less new pensioners receive a mere national pension, and the earnings-related pension has increasingly become the basic pension, which is complemented by the national pension.

In 1999 the poverty rate of the elderly population was 3 per cent, when using 50 per cent as the poverty line. As poor households are then defined those whose disposable income is less than half of the median disposable income for all households calculated per consuming unit. The poverty rate of the whole population was 4.1 per cent. In the same year, the income of 10.9 per cent of the elderly population and 9.8 per cent of the whole population remained under 60 per cent of the median income. The risk of poverty is higher for women, and especially women over 75, than for men (see Tables 1.2-1.5.).

The level of the national pension was raised (€ 12.28 /month) in summer 2001, and new child increases have been granted to pensioners since the beginning of 2002. A child increase is payable to pensioners for children aged under 16 years, its amount being € 18.08 per month and child.

In recent years the proportion of people aged 65 and over of the households in receipt of last resort income security, i.e. social assistance, has been 5 – 6 per cent (see Table 1.6). Pensioner households' proportion of the households on the lowest incomes is smaller that that of other population groups (see Figure 1.3). The financial standing of pensioners is better than that of other population groups. Although the gross wealth of pensioners is lower that that of the whole population, the low amount of their debts has the impact that their net wealth is higher than that of the others. (See Figure 1.4; Tables 1.7 and 1.8.)

CHALLENGES

The measures to avert the risk of poverty among older people have been successful in Finland. The income of pensioners can be considered to be reasonable compared to the situation of other population.

The risk of poverty is somewhat higher among older women than among older men. This is because national pension constitutes a bigger part of the present female pensioners' total pension provision in comparison to male pensioners. Some of these women have never had gainful employment for which earnings-related pension would have accrued. The younger generations are concerned, the fewer women live on mere national pension.

Ageing unemployed persons with low education level or weakened health are also at risk of poverty since they have not much chances of returning permanently to working life so as to increase their earnings-related pension. Furthermore, the income of persons on small incomes who continue in work increases only slightly and increases their total pension only partly, since their earnings-related pension reduces the amount of the national pension. There are no major incentives for work for these persons.

DEVELOPMENT STRATEGIES

The development of the level of the national pension is monitored and care is taken that its recipients get their share of the increased welfare in society. This can be realised for instance by separate increases in the level of pensions or by index increases.

Efforts are made to improve the incentives for people on low incomes to continue in work. According to the pension agreement of 2001 the present accelerated accrual of 2.5 per cent in the age range 60 - 65 will be replaced by an accrual of 4.5 per cent in the age range 63 – 68 years (see Target 5 for more information).

Target 2: Provide access for all individuals to appropriate pension arrangements, public and/or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement.

THE CURRENT SITUATION

The provision of statutory earnings-related pension insurance is divided into the pension arrangements of the private and the public sectors. The public sector pension arrangements include those of the state, local government and the church. The share of the private sector is about 70 per cent measured by the number of the insured. The contents of the pension insurance of the private sector and the public sector differ in details, but the main principles are similar. There are however differences in the techniques of financing the pensions.

The statutory earnings-related pension insurance is comprehensive, and it is mandatory for employers and self-employed persons to arrange it. Pension also accrues for short employment contracts. In practice, all work and self-employment increases a person’s future pension. The earnings-related pensions under payment are adjusted annually by an index. A person retains his or her pension entitlements in full after an employment relationship or self-employment has terminated (right to paid-up policy). There is no ceiling for an earnings-related pension. The purpose of national pension is to guarantee pensioners a reasonable minimum pension. If the pensioner does not receive any earnings-related pension or its amount is very low, he or she is paid a full national pension.

The target level for an earnings-related pension is 60 per cent of the pensionable pay and it is earned as a rule in 40 years. An old-age pension begins to accrue from the age of 23. The insured that are younger than this are on certain conditions entitled to disability pension and their family members to survivors’ pension. Before the pension reforms of the 1990s the pension provision of the public sector employees was better than that of the private sector employees. The rate of accrual was faster, the target level was better and the pensionable age lower before the reforms.

In practice the average accrual percentage is about 50 when taking into account employment in both the private and public sectors. In the private sector it has not been possible to earn the full 40 years’ pension entitlement by the year 2002, since the earnings-related pension scheme was created in 1962. The period in employment may be even shorter than full 40 years, e.g. due to a fragmentary working life participation.

The statutory earnings-related pension can be complemented by collective or individual voluntary arrangements. As the statutory cover is comprehensive, the demand for voluntary pension arrangements has been fairly modest (see tables 2.1 and 2.2.). In ratio to GDP the optional pension arrangements, i.e. pension provision under the 2nd and 3rd pillars, totalled in regard to pension funds about 10 per cent in 1999. The tax treatment of supplementary pension insurance is as a rule similar to that in the statutory pension provision: premiums are deductible, the return on funds is not taxed during the period of saving, and pensions are taxable income.

CHALLENGES

The Finnish mandatory and voluntary pension schemes are in place in regard to Target 2. The mandatory statutory system is comprehensive and the level of benefits is reasonable. The mandatory cover can be complemented by voluntary insurance.

No old-age pension accrues for persons under the age of 23 years.

Preparing for fragmentary and more diversified working careers may increase the need for supplementary pension schemes.

DEVELOPMENT STRATEGIES

According to the pension agreement of 2001, the age range for the old-age pension accrual will be extended so that from 1 January 2005 pension will accrue for wages earned from the age of 18 until the age of 68 so that all years in work increase the pension amount. The development of pension accrual in regard to e.g. periods of sickness, studies and child care will be investigated as suggested by the working group on the future pension reform.

The aim in respect to the private sector earnings-related pensions is to abandon co-ordination in the context of the reform of calculation of pensionable pay, exclusive of motor liability insurance pensions and industrial injuries pensions. At present the pensions and benefits from different schemes are confined to the target level of 60 per cent by co-ordinating them. The details of the changes to the co-ordination are negotiated and agreed in co-operation between the private, state and local government pension schemes.

The total reform of the calculation rule for pensionable pay is being prepared as agreed in the pension agreement of 2001. If no other consensus is reached on the calculation rule, the pensionable pay will be calculated from the beginning of 2005 in regard to employment contracts under the present Employees' Pensions Act on the basis of both the real earnings and the earnings of the last ten years as at present. A pension is granted calculated according to the option that is more advantageous to the pensioner. The pensionable pay coefficient for pensions calculated on the basis of the real earnings is calculated so that the total expenditure will remain at the present level. The present estimation of the weightings of the earnings-related part in such a coefficient is about 80 per cent.

Target 3: Promote solidarity within and between generations.

THE CURRENT SITUATION:

Finland has traditionally been a country of an even income distribution. The income distribution among the elderly population was all through the 1990s more even than that among the entire population. The comprehensive statutory pension provision in conjunction with taxation and other social income transfers has had the impact that income disparities among pensioners have remained reasonable compared to the entire population (see Table and Figure 3.1).

The average level of pensioner households' income is about 90 per cent of the income of economically active households when taking into account taxation, other income transfers and the small family size of pensioner households.

Immediately after the economic depression experienced in the early 1990s the income of older age groups remained at the earlier level better than that of working-age households. Thereafter the differences in the income development between age groups were however levelled out. Towards the end of the 1990s the income development of elderly households was slightly weaker that that of working-age households. The average income of older people was all through the 1990s about 80 – 90 per cent of the average income for the population. When the depression was at its deepest the relative income level of older people approached the average for the population, being 96 per cent of it in 1996.

Maintaining the future income of pensioners stable and reasonable in relation to the population in employment presupposes that the costs of population ageing will be reasonable and be divided smoothly between the different generations. Pension prefunding alleviates the pressures to raise pension contributions with the ageing of the population and equalises the intergenerational income distribution. Finland is prepared for the retirement of the after-war baby-boom generation since a partial prefunding system has been in place in the statutory earnings-related pension scheme since its introduction. The development of the level of contributions is reviewed in the context of Target 7.

CHALLENGES

The most important challenge for the financing of pensions and the solidarity between generations in the coming decades is to slow down the rise in the economic dependency ratio. This ratio is raised by the ageing of the after-war baby-boom generation, low fertility rate, early retirement and unemployment. The pensioners' percentage of the population is increasing at a rapid pace, and in 2030 every fourth Finn will have attained the age of 65 years.

In the end, the sustainable financing of the pension schemes depends on the adequate number of economically active population. With the reducing labour force there will be pressures to raise contributions or cut down benefits. Accordingly, it will be necessary to intensify the employment of unemployed persons and the productivity of work, to defer retirement, to increase staff training, to reinforce family policy, to prevent the exclusion of young people from the labour market, and to promote the employment of immigrants. Simultaneously it will be necessary to increase the pension funds and improve the financing system.

Owing to the indexation, the level of the pensions of young people, mainly those in receipt of a disability pension under national pension, and in particular that of older women on old-age pensions may lag behind the living standard of other population during a period of tens of years on pension.

DEVELOPMENT STRATEGIES

The intergenerational income distribution can be promoted by improving the linkage between contributions and benefits and by aiming at an optimally even development of pension contributions temporally. This can be realised by cutting down on pension expenditure or increasing the pension funds. Both methods have been used in Finland. Thanks to the reforms carried out in the 1990s the pension expenditure is estimated to be considerably lower in the long term than it would be without those reforms (see Target 7; Table 7.1). At the same time the financial pressures of the next few years have been alleviated. The Finnish earnings-related pension scheme is partially prefunding, and the reforms of the 1990s have vitally increased pension prefunding. The proportion of the pension funds under the earnings-related pension scheme has increased to a good 50 per cent of GDP, and the proportion of the total amount of the pension funds to 67 per cent of GDP. Further reforms are however needed to guarantee adequate income for older people and simultaneously keep the level of pension contributions reasonable.

It is stated in the pension agreement of 2001 for the private sector that in order to even out the pressures to raise the earnings-related pension contributions the following will be investigated:

- possibilities to increase, as of the beginning of 2003, the prefunding of old-age pensions for a fixed period of time;
- the need to raise the age limits entitling to retirement by means of separate agreements so that a part of the rise in life expectancy is directed at the active years;
- possibilities of controlling the pressures by a technique in which the amount of the starting pension depends on the development of life expectancy;

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The present pension system will be developed so as to encourage continuing in work. Income from work should be the primary option vis-à-vis an early retirement pension. The coping of older employees is supported by improvements in working life. Furthermore, employees' right to vocational rehabilitation will be realised and the prerequisites for participation in rehabilitation will be developed even otherwise. As stated in the Government programme, the objective is to defer the average retirement age by two to three years and to be prepared for the continuous rise in the average life expectancy. (See Target 5 for further information.)

There will be a shift towards applying the index for those who have attained the age of 65 years in the index adjustments of all pensions under payment. In order to guarantee an adequate pension level for those persons who become disabled for work in young years the amount of the starting disability pension will be raised by an age-dependent coefficient.

Financial sustainability of pension systems - sound financial basis

Target 4: Achieve a high level of employment through, where necessary, comprehensive labour market reforms, as provided by the European Employment Strategy and in a way consistent with the BEPG.

<u>THE CURRENT SITUATION</u>

The deepest economic depression since the World War II that Finland experienced in the early 1990s has been the most essential background variable influencing the development of the employment situation in the country until recent years. As a result of the depression the employment rate dropped from 74 per cent to 60 per cent. Since then the employment rate has risen rapidly in all age groups and most rapidly among those aged 55–64 (see Figure 4.1). The present employment rate (the ratio of the employed to working-age population) is 67.7 per cent. Men's average employment rate is 70.0 per cent and women's 65.4 per cent. Finnish women have traditionally been actively involved in working life, and the infrastructures of the Finnish welfare state have since the start been developed in a way supporting women's gainful employment – by providing comprehensive child care services and individual social security rights for the entire population.

In recent years the increase in the employment rate has been retarded in Finland especially as a result of the international cyclical recession. The slower growth has however been reflected less and more slowly than before in the Finnish employment rate. Companies have e.g. avoided large-scale notices and lays-off, as they want to prepare for the expected future shortage of labour. The unemployment rate, which has fallen evenly since 1994, is at present 9.1 per cent and the rate of long-term unemployment is 2.2 per cent.

CHALLENGES

With a view to increasing the employment rate it is necessary, on the one hand, to prolong people's working lives and defer the average age of retirement and, on the the other hand, to reduce unemployment, to prevent exclusion from the labour market and to activate the working-age people that are not participating in the labour force. Efforts must be made, in particular, to maintain the favourable employment development of older age groups, and the employment rate of 42 per cent for men aged 55 – 64 years must rise further. (See Figures 4.2 and 4.3)

A special challenge in increasing the employment rate is the average age of retirement that is at present lower than the official retirement age (see Figure 4.4). The age of exit from working life has to be raised before the baby-boom age groups retire on early pensions, since the demographic change will probably result in labour shortage in the country. The labour force will begin to reduce around 2006, jeopardising the prerequisites for a stable economic growth, which will contribute to slowing down the employment development. The situation today is that more than three out of four people aged 60 – 64 have retired on a pension in Finland. Particular challenges for postponing retirement are factors related to maintaining work ability, favourable attitudes of employees and workplaces and employees' occupational skills.

The challenge related to prolonging the working lives of younger generations is to boost an earlier entry to working life. In Finland, 80 per cent of those aged 26 are participating in working life. A special challenge is to hasten the transfer from upper secondary education to vocational education, which takes at present on average two to three years, as well as the duration of vocational education. It takes four to five years for every fourth person to take a vocational degree and longer that this for every fifth. On the other hand, Finland's goal with a view to safeguarding the proper functioning of the labour market is that the level of education among citizens must be as high as possible.

At present unemployment affects mostly the oldest and youngest age groups and regionally the so called development regions of Northern and Eastern Finland. The unemployment of older age groups (see Figure 4.5) is largely based on the same reasons as premature retirement. In addition, a great number of aged employees permanently lost their jobs as a result of the depression in the 1990s. A particular risk in the employment development of young people is the permanent exclusion of school drop-outs and unskilled young people from the labour market. A major reason for the regional unemployment is the concentration of economic growth in population centres.

DEVELOPMENT STRATEGIES

The objective of the Finnish Government is to continue the measures to increase the employment rate so that the average retirement age would rise by two to three years and the employment rate would exceed 70 per cent by 2010. The objective for women's employment rate is 68 per cent by 2010, and the objective for those aged 55 – 64 years is 55 per cent. In order to achieve these objectives the average retirement age must rise to 61 years by 2010. It is stated in the conclusions adopted at the Barcelona European Council in March 2003 that that the average age when people effectively cease to work within the European Union should be increased gradually by about five years by 2010. A major goal of the pension agreement of 2001 is to encourage continuing in working life and to increase the employment rate.

In employment policy Finland focuses on ensuring the proper functioning of the labour market and the supply of labour force. As regards the smooth functioning of the labour market attention is paid in particular to the following:

- ensure the supply of labour force,
- prevent youth unemployment and long-term unemployment and activate labour policy,
- promote social inclusion,
- support self-employment,
- improve the prerequisites for regional and local actions,
- develop working life, and
- reconciliate work and family life.

As labour policy measures are emphasised the training of labour force, development of professional skills and knowledge, and maintaining job applicants' activiness through a broadly-based national, regional and local co-operation.

It is stated in the Government programme that such changes will be realised in working life, actions to maintain work ability, educational policy and pension and unemployment security schemes as will encourage employers to keep in their service and hire older persons and promote their remaining in work and in the labour market. These measures will underpin the existing systems of social protection and infrastructures, such as employment service, occupational safety, occupational health care, rehabilitation systems and training, that vitally contribute to the attainment of the objective of increasing the employment rate.

The continuity of the stable economic policy pursued by the Finnish Government constitutes the foundation for supporting employment; we will return to this in the context of Target 6. The structures of social protection that encourage employment and their development will be dealt with in more detail in the context of Target 5.

According to the policy lines defined by the Government the working life and its conditions will be developed by enhancing the quality of work and well-being at work. The main responsibility for the improvement of working conditions is born by workplaces. Efficient occupational safety and occupational health care service and other expert services back up the activities of workplaces. The occupational health care services will be made more effective especially in small and medium-sized enterprises. The work of occupational safety and health authorities will be focused to a greater extent on promoting well-being at work. The labour market organisations also play a vital role in the development of working life. At the workplace level this development mainly involves knowledge, will and skills.

The educational policy measures that support access to employment are focused on shortening the period of training, converging education and labour market demand and, in particular, on implementing the principle of life-long learning. The objective of life-long learning is that all citizens should constantly have the know-how basis that enables their participation in working life and further development of their knowledge and skills. Life-long learning thus enhances the proper functioning of the labour market and the supply of skilled labour force and alleviates unemployment. In accordance with the objective of life-long learning, 55 per cent of Finns aged 25 to 64 took part in adult education in 2000. The objective with a view to preventing youth unemployment and exclusion is that all young people entering the labour market should have completed at least upper secondary school or vocational basic education, and that a considerable proportion should have polytechnic or university education.

Finland has a diversified and comprehensive rehabilitation system to maintain and develop work ability. Rehabilitation is organised by the Social Insurance Institution, employee pension institutions, accident insurance institutions, employment authorities, health care and social welfare systems, and educational authorities. In 2000 the total expenditure on rehabilitation amounted to € 1.2 billion, which is about 1 per cent of GDP. Authorities are responsible for providing rehabilitation in the form of vocational rehabilitation for people with disabilities and medical rehabilitation for people with severe disabilities. Other vocational and medical rehabilitation as well as early rehabilitation is organised to a large extent, in addition. The earlier fixed-term disability pension was replaced at the end of the 1990s by rehabilitation allowance, which supports re-entry to work and maintenance and improvement of work ability. In recent years, in particular those over 45 years have taken part in rehabilitation. A right of the insured to early rehabilitation is scheduled to be enforced within the earnings-related pension scheme as of the beginning of 2004; this right already exists in the national pension scheme.

Another important factor increasing the employment rate is to create an operational environment favourable to entrepreneurship and to boost the starting of business. The Government's project to promote self-employment includes measures to increase the proper functioning of markets and to encourage the taking up of self-employment.

The above principles are also included in the Government's regional policy measures for improving employment. Concrete measures will be undertaken on the basis of the objectives set at the regional level in broad co-operation involving the competent authorities, the economy, local NGOs, labour market organisations and educational institutions.

The above principles are also integrated into several special programmes for supporting employment. One of them, the National Programme for Ageing Workers (1998 – 2002) aims to improve the employment situation of those over 45 years and to reduce premature retirement. The experiences of the programme are encouraging and under further scrutiny. The diversified actions implemented in the programme will be continued within the framework of a separate continued programme in collaboration with labour market organisations.

An increase in the employment rate according to the defined objectives is not however enough to keep the ratio of pensioners to the employed at the present level. This ratio is estimated to rise from the present ½ to ¾ by 2035, after which there probably will not be any increase for two decades.

Target 5: Ensure that, alongside labour market and economic policies, all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers; that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age; and that pension systems facilitate the option of gradual retirement.

<u>THE CURRENT SITUATION:</u>

The basic structures of the Finnish social protection system that safeguard the health, income and well-being of people improve their opportunities and ability to remain long in working life. The system incorporates, among others, social security benefits, the social welfare, health care and occupational health care systems, and diversified rehabilitation options. The system is based on individual rights and covers all people permanently resident in Finland.

In the Finnish statutory pension system, disability pensions, unemployment pension, early old-age pension and part-time pension are pension benefits payable before the age of 65. Incapacity for work is the most common reason for being granted an early retirement pension (see Figure 5.1). As a rule, such a pension is granted for medical reasons related to the individual's health and work ability. Thus the incentives for an early pension are mainly linked to the last-mentioned three pension types. At present it is possible to retire on an unemployment pension and early old-age pension at the age of 60 and on a part-time pension, under the temporary law in force, at the age of 56 and from the year 2005 at the age of 58.

There are a great number of elements in the Finnish pension system that encourage an optimally long working career and facilitate flexible retirement. Accordingly:

- It is possible to retire gradually on an old-age pension: the pension can be taken earlier than normally or postponed, in which case the amount of the pension is reduced or increased respectively on actuary grounds.
- Part-time pensions facilitate gradual retirement.
- Pensions for employees aged over 60 years accrue according to the so called super accrual rate of 2.5 per cent (normal accrual is 1.5 per cent).
- When calculating the pension entitlement for the period remaining until the retirement age in granting a disability pension, pension accrues until the age of 49 at the rate of 1.5 per cent, in the age range 50 – 60 years 1.2 per cent and after the age of 60 0.8 per cent per year.
- Employers have own deductibles in regard to disability and unemployment pensions.

CHALLENGES

As much as 86 per cent of Finns retire before the statutory age entitling to old-age pension, and three out of four of those aged 60 to 64 years are receiving a pension. The most common reason for this is the weakened work ability of employees. The incentives for taking up early retirement and to give notice to older employees are often considerable. There are several types of early retirement pensions in the Finnish pension system. Unemployment pension and the related ‘unemployment pathway to retirement’ has been used as an instrument for removing older employees or for older employees’ exit from working life. The challenge in developing the early retirement schemes is how to adapt fairly the arrangements that were created under different societal circumstances so as to encourage longer working life participation.

However, reducing the types of early retirement pensions is not enough to solve the problem of how to raise the average retirement age, since retirement is essentially associated with, apart from the employers’ willingness to keep older employees in work, employees’ attitudes, health and work ability, and the development of the social protection system as a whole.

DEVELOPMENT STRATEGIES:

Achievement of the objective of a higher employment rate presented in the context of Target 4 would create a basis for deferring the average retirement age in Finland.

The pension scheme reforms started in the 1990s have reduced the options of early retirement and supported continuing in and returning to working life:

- The conditions for granting an unemployment pension have been adjusted i.a. by removing the part of projected pensionable service from a pension, by raising the age limits for granting a pension and supporting the job-seeking, training and subsidised jobs for persons that have landed or are at a risk on landing on the ‘unemployment pathway to retirement’.
- The pension rights of the public sector employees have been co-ordinated with those of the private sector; e.g. by raising the age of entitlement to old-age pension gradually from the age 63 to 65 and by reducing their pension accrual.
- The age limit for an early disability pension, i.e. to a disability pension granted on alleviated conditions, has been raised from 55 years to 58 and further to 60 years.

According the recommendations of the SOMERA Committee the Finnish social security should be developed by adjusting the relationship between benefits and earnings so that the financial incentive to take part in working life, continue in work and return to work is retained. This presupposes further development of the co-ordination rules concerning pay, taxation, indirect labour costs and primary social security.

According to the pension agreement of 2001 the pension system will be developed further by reducing early retirement pensions, increasing the incentives for continuing in work and by simplifying the pension system. The purpose is that the major part of the changes suggested will be effected at the beginning of 2005. The main principles of the agreement are as follows:

- It would be possible to retire on an old-age pension flexibly from the age of 62 to 68. The employee could choose if he or she continues in work and increases his or her future pension or retires on the pension earned up to that point of time. A so called early retirement penalty is made in the pension of a person retiring at the age of 62 for each month preceding his or her 63rd birthday. Retirement is tried to be deferred by an incentive accrual of 4.5 per cent. When deferring retirement beyond the age of 68 years the person’s pension would be increased by 4.8 per cent per each postponed year.
- For those born in 1947 and later the conditions for part-time pensions are proposed to be changed so that the age limit would rise from 56 to 58 years. When being on a part-time pension old-age pension would accrue at the rate of 1.5 per cent of the pay for part-time work but only at the rate of 0.75 per cent of the part of pay equivalent to part-time pension, instead of the present 1.5 per cent.
- Unemployment pension would be abolished gradually, and the income of those born after 1949 would be taken care of through income security arrangements for the unemployed.
- Early disability pension will be abolished in regard to persons born after 1943.

According to the calculations made the reforms suggested in the agreement are estimated to increase the employment rate in the long run and under favourable economic development by a good percentage point.

Target 6: Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds.

<u>THE CURRENT SITUATION</u>

Earnings-related pensions are financed by the contributions collected from the insured and employers and by the revenues of the funds. National pensions are financed by the contributions collected from employers and by tax revenues.

The Finnish pensions system has been reformed especially since the ’90s with a view to improving its financial sustainability. Some of the changes have been reviewed in the context of Target 5. These changes are estimated to reduce the pension expenditure of 2040 by almost one fifth.

Owing to the partial prefunding of earnings-related pensions the pressures to raise pension contributions remain essentially lower that those concerning pension expenditure. The prefunding rate in regard to statutory earnings-related pensions is today a good quarter of the value of the accrued pension entitlements, and the market value of the investments of these pension funds is a good half of GDP. The proceeds of the funds together with the pension contributions result in surpluses in the public economy. The annual surplus of the statutory pension funds is at present about 3 per cent in ratio to gross production.

The public pension expenditure has been affected essentially by i.a. the following changes in the system:

- reduction of the public sector pension accruals to the level of the private sector,
- raising the age limit for old-age pension in the public sector by degrees from 63 to 65 years,
- reduction of the earnings-related coefficient of the earnings-related pension indexes for those in receipt of old-age pensions,
- removing the basic amount of national pension, when the national pension became wholly earnings-related,
- reduction of the accrual of projected pensionable service in respect of disability and unemployment pensions,
- in the calculation of pensionable pay, changing over to applying the rule of the last 10 years instead of the earlier 4 years.

The total tax ratio has declined in recent years in Finland. In international comparison the Finnish tax rate (45 %) however appears to be high, although comparisons of total tax ratios between states are not unambiguous. Different countries' practices differ regarding, for instance, if social security benefits are taxable income or if separate deductions are granted in taxation or in social security contributions on social grounds. In Finland the major part of income transfer benefits are taxable and almost all of the deductions related to determining a person's tax-paying ability that were granted earlier have been abolished.

CHALLENGES

Despite the implemented reforms the ratio of pension expenditure to GDP will according to the present projections increase with the population ageing and under the present legislation by about 5 percentage points from 11 per cent to 16 per cent. The expenditure on earnings-related pensions will increase by 6 percentage points and the expenditure on national pensions by about one percentage point in ratio to the gross production. The need to raise the earnings-related contributions is about 10 per cent of the insured person's earned income in 2010- 2030. The projected increases in health care and social spending in the same period will involve a further strain on the balance of the public economy. The biggest challenge for the financial sustainability of public economy will be the diminishing employment potential with the retirement of the after-war baby-boom generation. The economic growth rate threatens to slow down from the earlier 3 per cent to about 1.5 per cent a year. The biggest challenge from the point of view of the public economy and pension schemes is to keep people in working life longer than at present.

In international comparison the state of the Finnish public economy is at the moment good. In the next couple of decades there will however be big financial pressures on the management and balance of public economy, particularly as a result of the increased expenditure on pensions and care services due to the population ageing. Finland has managed to reduce its national debt; it is now about 46 per cent in ratio to the country's gross production. The interests payable on it are at present about 12 per cent of the total expenditures of the state. The financial pressures will be increased by e.g. the international tax competition. This competition tends to weaken the potential of the public economy to finance social benefits.

Retaining the financial balance of public economy is largely linked to the predictable production growth and the development of wages and taxation. The possibilities to pursue a given financial policy are furthermore strongly linked to the national economic development and the related factors of uncertainty.

DEVELOPMENT STRATEGIES

The primary objective of the Government’s economic policy is to safeguard the economic growth and to improve the employment situation, and succeeding in these is one of the most important elements in curtailing the growth in pension expenditure with the ageing demographic structure. It is important for ensuring the financial balance of the pension schemes to prolong people’s working careers and to reduce the incentives for early pension arrangements in accordance with the policy lines presented in the context of Targets 4 and 5 so that the proper functioning of the labour market and the supply of labour force can be ensured (see Figure 6.1).

The basic goal in the Government’s economic policy is to reform taxation and social security benefits so as to improve the employment situation. The Government aims to ease the grounds for income taxes and social insurance contributions, which presupposes that the strong growth must continue, as well as moderate income policy decisions and development of the tax structure. The co-ordination of taxation, social security and service fees will be intensified to the effect that the incentives for seeking jobs will improve. With a tight budget policy the Government aims to ensure the structural financial surplus in public economy, which will be used, in the first place, for reducing the government debt. Succeeding in following the defined policy lines will improve the financial position of the public economy and curb the pressures to raise taxes, which will create room for the future increase in pension and care expenditure.

In order to ensure an optimally smooth development of pension contributions Finland aims to increase the pension funds and to raise the real proceeds from the funds to as high a level as possible taking into account their solvency. According to projections it is possible to increase the funds on the basis of the decisions already made so that the statutory pension funds will be about 80 per cent of GDP and 200 per cent of the wages paid around the year 2020 (see Figures 6.2 and 6.3). The purpose is to finance about 20 per cent of the pensions under payment by the revenues of the funds. The rate of revenues can be increased in the long term by shifting the focus in investments towards investment in shares. If Finland also manages to raise the employment rate as envisaged, the pension expenditure can probably be held in check as outlined in the present financing plan.

From the perspective of the financial sustainability of the public economy economic growth is the most important element. The pension and unemployment security reform, which will be effected in main parts at the beginning of 2005, will considerably improve the incentives for work and defer retirement. Furthermore, it is important to see to it that the growth of production will continue at a moderate rate, for instance by investing in education and know-how.

Target 7: Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter.

THE CURRENT SITUATION

A number of reforms were realised in the Finnish pension system in the 1990s resulting in considerable savings in future pension expenditure. The first such reform concerned survivors’ pensions. One motive for reforming them was the requirement for equality, and widowers were accordingly given a right to survivors’ pensions. A pension adjustment is however applied in the payment of survivors' pensions so that the widow's/widower's own pensions are taken into account when determining the survivor's pension.

In the public sector, reforms that reduce the expenditure were realised in 1993 and 1994. The period of pension accrual, the target level and the pensionable age were adjusted to correspond to those applied in the private sector. In the private sector savings were generated by e.g. raising the lower limit for an early retirement pension from 55 to 58 years.

The responsibility of future pensioners for maintaining the pension system was increased by introducing the wage-earner's contribution in 1993. It reduces the income on which a pension is based, and thus the increased pension contribution diminishes the future pensions. The employees' pension contribution was made a permanent part of the system of financing earnings-related pensions so that employers and employees have been fifty-fifty accountable for financing the change in the earnings-related pension contribution since 1994.

The most important savings resulting from the pension reform of 1996 in the earnings-related scheme were generated by changes in the calculation of the pensionable pay, determination of the projected pensionable service and in the index system. Earnings-related pensions have been determined since 1996 on the basis of the earnings of the last ten years, instead of the earlier four years. The entitlement to the assumed time between pension contingency and pensionable age was limited and the accrual percentage for assumed time was reduced. A specific index for persons of pensionable age was introduced, in which the weightings in the changed earnings were reduced from 50 to 20 per cent. An important change was also the introduction of the pension-tested national pension in 1996.

Thanks to the reforms concerned, pension expenditure can be estimated to be considerably lower in the long term (in 2030) than what it would be without these changes (see Table 7.1). The reforms also support the working life participation of older employees, as it is a more favourable option to continue in work than to retire before the standard pensionable age.

CHALLENGES

The implemented measures have reduced the pension expenditure and supported continuing in working life, but further reforms are needed because of the weakening economic dependency ratio. The increase in the ratio of pensionable years to years in service caused by the increased life expectancy will raise insurance premiums irrespective of the manner of financing, if the present level of benefits is to be retained. The sustainable financing of the pension schemes essentially depends of the relationship between the length of working career and that of retirement. The Government programme underlines the importance of measures that reduce the need for increasing pension contributions, i.e. raising the average age of exit from the labour market and accordingly the retirement age by two to three years in the long term.

The change in the demographic structure and the projected increase in life expectancy would require raising the earnings-related pension contributions by several percentage points in 2015-2030, after which their growth would slow down according to the calculation extending to the year 2050 (see Figure 7.1). Under the legislation in force, the ratio of the expenditure on national pensions to GDP would decline in the same period to less than half of the present ratio (see Figure 7.2).

DEVELOPMENT STRATEGIES

The overall goal of the pension agreement of 2001 is to create incentives for longer working careers and to postpone retirement. According to the agreement some types of early retirement pensions will be abolished, the linkage between contributions and benefits will be intensified and the benefit level earned on the basis of a long working career will be raised. Furthermore the start of entitlement to an old-age pension is made flexible between the age range 62 – 68 years.

Any increases in pension contributions will be kept as even as possible and the burden of payment between generations equitable. It will be investigated, among others, if it is possible to increase the prefunding of earnings-related pensions, to take into account the increased life expectancy in the determination of pensions, and to gradually raise the age limits in pension legislation. The objective is to keep the ratio of the retired to the active stable and the poverty risk of pensioners low, and to guarantee a decent consumption level for pensioners. The insured could maintain the ratio of pension to pay at the present level by prolonging their working careers correspondingly.

The transparency and incentives involved in the financing will be improved according to the SOMERA Committee's recommendations. The linkage between earnings-related pension insurance and contributions will be intensified. Observing the insurance principle presupposes a gradual removal of those employer contributions that are not related to working. The financing of the national pension contributions must be discussed in conjunction with health insurance so that their financing is secured in a stable and sustainable way.

The policy lines outlined in the strategy of the Ministry of Social Affairs and Health up to 2010 include adjustment of the earnings-related pension index so that it takes into account social equity and the evolution of the national economy.

Target 8: Ensure, through appropriate regulatory frameworks and through sound management, that private and public funded pension schemes can provide pensions with the required efficiency, affordability, portability and security.

THE CURRENT SITUATION

There are very detailed law provisions on the administration of statutory earnings-related pension insurance. Within the framework of the law the pension institutions are however independent in their decision-making. The pension institutions thus decide themselves for instance how to invest the pension assets from insurance premiums. Since the statutory pension insurance however is a part of social security, there is a specific guarantee scheme in the private sector earnings-related pension scheme for possible insolvency of a pension institution. The earnings-related pension benefits are therefore always safeguarded. It is also vital from the point of view of the insured that a right to a paid-up policy ensues from every employment relationship once it is covered by the law. The State Treasury is in charge of matters concerning earnings-related pensions in the state sector, and the Local Government Pensions Institution in the municipal sector. The Insurance Supervision Authority supervises the employee pension institutions of the private sector as well as other insurance institutions.

The employee pension institutions apply to the Ministry of Social Affairs and Health for advance confirmation of the premiums they intend to collect. The same applies to e.g. the bases for technical provisions and the minimum return on technical provisions.

A partial prefunding technique is applied in the financing of private sector wage-earners' earnings-related pensions. The prefunding is linked to individual pension liabilities. The return on pension funds is used for evening out the rise in insurance premiums.

The part of the assets collected for local government pensions that is not immediately used for payment of pensions is transferred to a fund to cover future pension liabilities. The prefunding was started in 1988. According to the law, when investing the assets it must be ensured that the investments and return on them are secure and that the investments are convertible into money and diversified.

The State Pension Fund obtains the major part of its assets from the pension contributions of the employers and employees covered by the state pension scheme and from the return on the assets of the fund. The assets of the Pension Fund have not yet been used for payment of pensions, but all the pensions covered by the state pension scheme are paid out of the grants reserved in the state budget. It has been stipulated therefore that a certain amount of the assets of the fund can be transferred to the state budget. The part of the assets that is not used for the transfer can be lent to the state or invested.

The pension prefunding of the local government and the state is not tied up to individual pension liabilities but they constitute buffer funds. The objective of the state and local government prefunding is a partial prefunding equivalent to that concerning the private sector pensions.

The statutory employee pension funds amount to a good 50 per cent of GDP, and are projected to rise to almost 80 per cent of GDP by 2030 (Appendix, Figure 6.3). Figure 8.1 indicates the development of the investment portfolio in 1996-2001, including almost all pension institutions.

The statutory earnings-related pension insurance of the private sector is managed by private employee pension institutions: authorized pension insurance companies, insurance funds, pension foundations and four separate special pension institutions. At the beginning of 2001 the pension insurance under the Employees' Pensions Act, i.e. of about half of the Finnish labour force, was administered by 6 pension insurance companies, 8 insurance funds and 37 pension foundations. These pension institutions compete with each other for those taking out policies. The most important competitive tools are the efficiency of customer service and return on the investment of assets. The higher the return is the bigger are the bonuses to be distributed from the proceeds, in other words the reductions in premiums granted to policyholders and the insured.

The major objective of the investment of earnings-related pension assets is to secure pension financing from the point of view of, on the one hand, the security of investments and, on the other hand, optimal return on them.

After the change in the investment environment of pension institutions, the provisions on the investments and solvency of private sector employee pension institutions were revised beginning from 1997. The reforms concerned both pension companies, pension foundations, insurance funds and special pension institutions. They were based on the objective set for the investment of pension assets to achieve a higher return in the long term. The final goal was to reduce the pressures to raise the earnings-related pension contribution and thus to support the sustainability of the pension scheme. The employee pension institutions should therefore be able to invest to a greater extent in those types of investment whose return estimate is higher in the long term but which are also linked with a higher risk. The solvency buffers, i.e. solvency margins of the employee pension institutions, were increased and the supervision of solvency was improved in order to carry the increased investment risk.

The solvency mechanism consists of several limits and zones between them. In respect of the authorized pension insurance companies these zones are called target zones, zones of limited profit distribution and crisis zones. In the target zone the operations of the pension company are restricted only slightly. In the zone of limited profit distribution a pension insurance company must increase its solvency in accordance with the principle of prudence by limiting the bonuses to customers and profit distribution to owners. In the crisis zone pension companies are required to prepare either a reorganisation plan or a financing plan. A similar mechanism is also in place for pension foundations, insurance funds and special pension institutions.

The requirement for pension institutions' solvency margin was determined to depend on the riskiness of their investment distribution. Those types of investment whose return and values fluctuate strongly require a bigger risk buffer than risk-free types of investment do. For instance a pension institution that invests a great proportion of its assets in shares and real estates is required to have a bigger solvency margin than, for instance, a pension institution that mainly invests in state bonds. The board of directors of the pension institution and the supervisory authority are able to monitor the development of the institution's solvency by means of key figures and, in case of weakened solvency, interfere and start steering the operations of the pension institution, as appropriate, at a sufficiently early stage.

The technical rate of interest is the long-term profit target for pension assets. It is the minimum requirement for return common to all pension institutions, and it is confirmed by the Ministry of Social Affairs and Health. The technical rate of interest affects differently the premiums of different types of pension institutions. As regards pension insurance companies there is no direct connection between premiums and the technical rate of interest, whereas the rate affects the premiums of pension foundations and pension funds. The connection arises so that the return on investments exceeding the technical rate of interest can be used in these pension institutions for covering the costs of the pension institution, and it thus reduces the need for premiums. A technical rate of interest that is set high thus reduces the amount of excess yields and presupposes higher premiums.

Provisions on the investment plan are laid down in the law, since it is essentially question of a document that is linked to the solvency of a pension institution and its supervision. The boards of directors of pension institutions approve the investment plan, which has to be submitted to the Insurance Supervision Authority

The operations of pension institutions are regulated, in addition, by Decrees concerning the assets covering technical provisions and by regulations issued by the Ministry of Social Affairs and Health and the Insurance Supervision Authority.

Voluntary pension insurance can be arranged in a pension foundation, insurance fund or life assurance company or e.g. as a book provision. The Insurance Supervision Authority is responsible for the supervision of insurance institutions. Solvency requirements for supplementary pension funds under the second pillar, which administer occupational pension insurance, are being prepared in the European Community as part of the Directive on supplementary pension funds. The provision of individual pension insurance by life assurance companies is regulated by the third life assurance Directive.

In 2000 the total operating expenses of pension insurance from which the administrative costs of investments are deducted were in ratio to the premium income 2.7 per cent, including the operating expenses of the statutory earnings-related pension insurance and national pension insurance, and optional supplementary pension insurance. The operating expenses of life assurance companies were about 4.9 per cent of their premium income. The operating expenses of the authorized pension insurance companies were 2.8 per cent of their premium income.

In 2001 a separate law was enacted on the supervision of financial and insurance clusters. By a financial and insurance cluster is meant a group of undertakings including both financial and insurance undertakings. A group of undertakings is defined as a cluster if the parent company is a credit institution, investment firm, insurance company, or a holding company referred to in the law, and if at least one of the undertakings belonging to the cluster is a Finnish credit institution or investment firm, and at least one of them is a Finnish insurance company. Authorized pension insurance companies are not counted in a cluster. Some provisions concerning the reporting obligation and the right of inspection and access to information are however applied to the pension foundations, pension funds and authorized pension insurance companies that are operating in a close contact with an undertaking that belongs to a cluster. The co-ordinating supervisory authority designated for a financial and insurance cluster is either the Financial Supervision Authority or the Insurance Supervision Authority

CHALLENGES

The cost-effectiveness and the return on investments of the pension institutions administering the private sector statutory pension insurance were assessed by a working group operating in 2000-2001. The development needs observed by the working group concerned, among others, establishment of a new pension institution and the technical rate of interest that essentially affects financing.

According to the assessments made it is necessary to increase the return on employee pension funds in order to curtail the pressures to raise the earnings-related pension premiums. Facilitating the establishment of a new pension institution would support the further maintenance of the decentralised pension system and the aspirations for higher returns through increased competition. According to the objective set for the pension system the level of the technical rate of interest must be kept as high as possible. The ultimate goal is to reduce the need to raise the earnings-related pension contributions and thus to support the sustainability of the pension scheme.

The effectiveness of the rules regarding coverage and solvency must be monitored in the changing investment market situations. They considerably steer and regulate investment operations.

It is also important to ensure optimal returns on investments in the state and local government pension schemes.

DEVELOPMENT STRATEGIES

According to the pension agreement of 2001 the mechanism for determining the technical rate of interest is defined so that it underpins the financial balance of the earnings-related pension scheme in the long term and is suitable for all pension institutions. Possibilities to increase the prefunding of old-age pensions from the beginning of 2002 are being investigated in order to reduce the pressure to raise the earnings-related pension contribution.

Modernisation of pension systems in response to changing needs of the economy, society and individuals

Target 9: Ensure that pensions systems are compatible with the requirements of flexibility and security in the labour market; that, without prejudice to the coherence of Member States' tax systems, labour market mobility within Member States and across borders and non-standard employment forms do not penalise people's pension entitlements and that self-employment is not discouraged by pension systems.

THE CURRENT SITUATION

In Finland about one third of all employment relationships are based on fixed-term contracts and about one seventh of the employed are entrepreneurs (see Figure 9.1). In the statutory earnings-related pension scheme a person's all employment relationships and periods of self-employment are taken into account in pension calculation as periods increasing the pension entitlement. Geographical or sectoral mobility does not result in a loss of pension entitlements for individuals.

The employer is responsible for providing the statutory earnings-related pension insurance for all those in his or her service irrespective of the temporal duration of the employment relationship. Short-term or otherwise non-standard employment contracts are also covered by pension insurance, and they add to the pension entitlement normally, provided that the income from them exceeds € 690.97 a year (in 2002).

Self-employed persons have in Finland their own mandatory pension laws and pensions. Independent businessmen and professionals must insure their activities under the Self-Employed Persons’ Pensions Act, and farmers, fishermen and those engaged in reindeer husbandry under the Farmers’ Pensions Act.

Private sector earnings-related pensions are applied for from the pension institution in which the person was last insured under the earnings-related scheme. According to the principle of last institution, the last pension institution of a person combines and grants the separate pensions accrued to the person on the basis of the different types of earnings-related pensions. The pension institution that pays the pension collects the pension items under the responsibility of other institutions that are possibly included in the pension on the basis of the mutual system of division of liabilities. A national pension can be applied for in connection with the application for earnings-related pensions.

The pensions of persons moving to the European Economic Area accrue according to the Regulation on the co-ordination of social security for migrant workers under the legislation of the country in which they are employed. When retiring the person is entitled to pensions from all those countries in which he or she has earned pension entitlements. Thus movement within the EEA and EU Member States does not result in any loss of pension entitlements, and the pensions one has earned within the EEA are paid to Finland without limitations. The earnings-related pensions earned in Finland are paid without limitations to EU citizens in the states being part of the EEA. The payment of earnings-related pensions to third countries is for the time being subject to a special permission by the Central Pension Security Institute.

It must be noted, too, that a low earnings-related monthly pension is complemented in Finland by national pension for all persons with pension rights in the country.

CHALLENGES

The maintenance of pension entitlements is guaranteed appropriately in the Finnish earnings-related pension scheme, and it does not involve special challenges for its development. The portability of pensions within the EEA is likewise guaranteed.

An automatic and flexible export of pension entitlements to third countries would presuppose further measures.

When implementing the principle of last institution the pension payment transactions in regard to public and private pension arrangements are not harmonised.

DEVELOPMENT STRATEGIES

The Finnish Government is preparing a bill that would give pensioners an unlimited right to export Finnish earnings-related pensions to the territory of any other state.

The principle of last institution will be expanded in 2004 to cover state and local government pensions.

Target 10: Review pension provisions with a view to ensuring the principle of equal treatment of women and men, taking into account obligations under EU law.

THE CURRENT SITUATION

The comprehensive and statutory pension system in Finland guarantees the equal treatment of women and men. The benefits, pension contributions and entitlements are individual and independent of the pensioner's gender. The national pension scheme plays the central role in providing a right to an own minimum pension for those women who have stayed outside the labour force, or taken care of children or cared for other family members at home for years. As it is pension-tested it also evens out those pension income disparities between women and men that the earnings-related scheme entails.

At the end of 2000 the average total pension of old-age pensioners (including survivors' pensions) amounted for men to about € 1,151 and for women to about € 841 per month. The average pension of an old-age pensioner was about € 870; for men about € 1,143 € for women about € 695 a month.

The reason for the differences in men's and women's old-age pensions is, inter alia, lower average of women's pay level. Women's wages are about 80 per cent of men's wages. In addition, there are often more breaks in women's working career, owing to e.g. child care periods.

<u>CHALLENGES</u>

Earnings-related pensions have become an increasingly important form of income security during retirement for both men and women. In other words, fewer and fewer representatives of the younger generations will be living on a national pension. Career breaks affect the earnings and pension accrual – to a greater extent women's pensions than those of men. It is difficult to acquire a full earnings-related pension because of care leaves and long periods of studies. For people on small incomes the national pension compensates for the smaller proportion of earnings-related pension.

<u>DEVELOPMENT STRATEGIES</u>

It is proposed in the pension agreement of 2001 that the Government should prepare a bill to reform the pension accrual for unpaid periods as of 1 January 2005 according to the following guidelines:

- Pension accrues for periods of sickness allowance, parents' allowance and home care allowance on the basis of the allowance or other benefit in case no pension otherwise accrues for the benefit period.

- Pension accrues for students that take a degree on the basis of study grant for five years at the most.

- It will be investigated if there are other unpaid periods for which pension should justifiably accrue.

The Government has promised to assess the impact of the designed amendments on the pension provision of women and men when preparing the relevant pension laws.

Target 11: Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. Develop reliable and easy-to-understand information on the long-term perspectives of pension systems, notably with regard to the likely evolution of benefit levels and contribution rates. Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.

THE CURRENT SITUATION

In Finland the social partners play a major role in developing the private earnings-related pension scheme. The decisions concerning the scheme have been taken since the introduction of the scheme in negotiations between the labour market central organisations, whose outcome Parliament has confirmed by separate pension laws. The agreements concluded have gained broad consensus in society. The decisions to develop the private earnings-related pension scheme have, as a rule, also been implemented in the public sector. The fact that pension policy reforms are agreed on a tripartite basis between labour market organisations and the Government creates stability and predictability for the proper functioning of the system.

The Finnish pension system has adapted well to changing circumstances. Even long-term challenges and acute demands placed by the depression have been responded rapidly and comprehensively. The changes made in the 1990s apply to both the national pension and the earnings-related pension scheme and to the present and future pensioners.

An important quality of pension provision from the point of view of citizens' confidence is that it is based on defined benefits without a ceiling. There is a distinct quantitative objective of 60 per cent for earnings-related pensions, irrespective of the income bracket. Furthermore, citizens are entitled to get information about the earnings-related pension that has accrued for them. Except for state employees, all other employees obtain free of charge a pension record including a list of their gainful employments and a pension estimate. This record is sent to those who are or have been employed by a private employer in about twelve months from the termination of each employment contract. Those who are or have been in municipal service receive the record at least once. In addition, from the age of 35 onwards the insured receive the record from their pension institution at the interval of about five years. The record can also be ordered separately e.g. by telephone and soon also via the Internet. Furthermore, specific theme days are arranged and pension schemes are presented at various fairs. The insured are also served by e.g. the local offices of the Social Insurance Institution and by pension companies.

Citizens' opinions about and confidence in the pension schemes are investigated from time to time by questionnaire surveys. The latest such survey was carried out at the end of 2001. Compared with earlier surveys citizens' optimism in retaining their own pension entitlements has increased. A markedly smaller proportion (41 %) of people believe that their pension benefits will be weakened compared with the previous survey of 1998 (58 %). On the other hand, a narrow majority (52 %) believe that there will be a reform in the next ten years that will reduce the pensions from the present level. Finns assume that the amount of an earnings-related pension is roughly 56 per cent of gross wages after 40 years of employment. On the other hand, people wish that that an earnings-related pension could rise up to 67 % of gross wages. The majority (57 %) think that there will be enough money for paying their pensions although the pension benefits remain at the present level. The confidence in the adequacy of pension benefits in the future has been strengthened among citizens by seven percentage points since 1998.

CHALLENGES

With a view to clarifying the pension system it would be necessary to combine employees' pensions acts and to simplify the earnings-related pension legislation. The earnings-related pension provision is based on several laws and the amendments made to them as a result of the changing circumstances have made the acts very complicated.

The changing operational environment will continue to pose challenges for the adaptability of pension schemes. The adaptation based on decision-making has been successful, but in order to increase the stability of the schemes in the long term it may be necessary to formulate the internal operational principles of the pension schemes so that the schemes adapt themselves automatically, in the way desired, to changing circumstances. For instance, the increased life expectancy could be taken into account without constant pension reforms.

From the point of view of the efficient monitoring of pension reforms and pension policy it is necessary to obtain information about other EU Member States' pension schemes and adjustments to them. It is especially important to Finland, owing to our way of building up pension provision, to obtain reliable reference data about the total expenditures on pension provision in different Member States, including the expenditures on both public and private pensions. It has proved very difficult obtain such information. To collect and increase this information is one of the most important objectives for and benefits of the EU's co-operation in the field of pensions.

DEVELOPMENT STRATEGIES

The goal of the pension agreement of 2001 is to create the prerequisites for combining and clarifying the private sector employees' pensions acts. The purpose is to develop the calculation rule for pensionable pay so that it will produce as equitable pension provision as possible. In that context the pension acts for the private sector wage-earners, except for the Seamen's Pensions Act, will be combined into one act so that employers are able to manage the pension insurance of all their employees by means of one insurance.

A working group appointed by the Ministry of Social Affairs and Health has investigated ways to increase the information about and transparency of pension institutions' operations. It proposes in its report of February 2002 that, for this purpose, each pension institution should be obliged to submit, as appropriate, uniform key figures concerning its operations. Producing the key figures should be started so that the first reporting year is 2002, for which information would be produced and published at year level. Beginning from 2003 interim information should also be produced. The co-ordination work for implementing the proposal has already been started.

It will be investigated how the adaptability and sustainability of the pension schemes could be strengthened in the changing – both national and international – circumstances. The aim is to develop the pension system so that it will respond automatically to predictable changes in the future, such as the increasing life expectancy, taking at the same time into account that the citizens' right to decent pension provision is guaranteed and that citizens' confidence in the system is retained.

The services for the insured will be developed further, as well. In a near future the insured will be able to manage their pension matters via the Internet. In December 2002 an Internet service common to the entire earnings-related pension sector will be introduced. It will be divided into services open to all and services requiring identification. The former inform about the grounds for the earnings-related pension schemes and the benefits provided by them. There will be, among others, a pension application form and a pension calculator on the pages. In addition, the pages provide topical information about pensions. The services requiring identification contain a list of each inquirer's personal employment relationships and periods of self-employment. At a later stage it will be possible to order a pension calculation or submit a pension application via the Internet.

As regards the Member States' co-operation on pensions Finland aims to advocate improving the methods of efficient monitoring of pension reforms and policies so as to promote, in particular, the comparability of total expenditures on pension provision. This presupposes co-operation by experts in the statistics and functions of pension systems between the Member States.

* * *

APPENDIX TO THE REPORT: Government bills given after submission to the Government of the report dealing with the development of the private sector earnings-related pension scheme, and the agreement of 5 September 2002

After the completion of the National Pension Strategy Report the Government of Finland has submitted to Parliament bills in which the pension agreement of 12 November 2001 is taken into account. Parliament has already approved part of the proposed amendments and will probably approve the rest of them during the ongoing year (2002).

Accordingly:

- From the beginning of 2005 the lower age limit for a part-time pension rises to 58 years. This rise applies to employees born in 1947 or thereafter.

- In the future, retirement on a part-time pension will reduce the amount of an old-age pension so as to make full-time employment more profitable than part-time employment in respect of pension accrual.

- Early disability pension will be abolished in regard to persons born after 1943.

- Persons that are, owing to illness, handicap or bodily injury, at risk of becoming disabled in the way referred to in the National Pensions Act or in the employees' pensions acts, will be entitled to vocational rehabilitation that the Social Insurance Institution and the employee pension institutions are obligated to organise. The amendment is proposed to come into force from the beginning of 2004.

On 5 September 2002 the central labour market organisations signed an agreement that complements and specifies the guidelines for developing the private sector pension scheme as agreed on 12 November 2001. The Government will submit to Parliament a bill corresponding to these adjustments in October 2002. The most important proposals for amendments in the complementary agreement are the following:

- According to the calculation rule for pensions to be applied from 1 January 2005 a pension is calculated on the basis of the wages and the accrual rate for each year of working career. For the calculation of the pension, the wages for each year are adjusted to the level at the date of commencement of the pension.

- If the insured retires on a pension before 2012 from such employment covered by the Employees' Pensions Act that has started before 2005, the pension is also calculated according to the Act that is in force at present. The present pension is compared to the pension calculated in the new way and the better option is chosen.

- In the age range 53 to 62 years pension accrues, instead of at the basic rate of 1.5, at the rate of 1.9 per cent of the annual wages.

- For a person who engages in gainful employment after the payment of old-age pension has started, pension accrues for this employment at a rate of 1.5 per cent in the age range 63 to 68 as well. The employment at this age range raises the annual accrual rate to 4.5 per cent.

- From the age 53 the employee pension contribution is 30 per cent higher than for those under 53. This amendment will take effect in 2005.

- When using the wage coefficient the weighting of the earnings index is 80 per cent and that of the consumer price index 20 per cent.

- The present pension index will be applied to the index adjustments of all pensions under payment; in this index the weighting of the consumer price index is 80 per cent and that of the earnings index 20 per cent. This new rule will be applied for the first time when raising pensions from the level of 2004 to that of 2005. The amendment applies to all pensions payable to the insured themselves (old-age, disability and unemployment pensions, early disability pensions, rehabilitation allowances, cash rehabilitation benefits, and part-time pensions) as well as to survivors' pensions.

- Pension co-ordination is given up in regard to private sector earnings-related pensions starting in 2005 or thereafter, except for the co-ordination with pensions payable on the basis of injuries from road accidents and industrial injuries. This means that the relative pension ceiling of 60 per cent is removed.

- The so called lifetime coefficient is introduced, i.e. a mechanism that adjusts the pension provision and pension expenditure to the changed life expectancy.

- From 1 January 2005 old-age pension starts to accrue for some unpaid periods during which the employee is paid earnings-related daily allowance. Such periods are maternity, paternity and parental leaves, unemployment and job alternation leaves, and various spells of training, rehabilitation and illness. When calculating pension accrual for unpaid periods the accrual is 1.5 per cent of the earnings on which the calculation is based.

- In order to level down the increase in employee pension contributions caused by the baby-boom age classes the old-age pension funding will be increased as from 2003 aiming at a smooth development of the employee pension contribution.

- As from 1 January 2005 retirement on an early old-age pension will no more be possible for persons under the age of 62.

APPENDIX 1: STATISTICS AND TABLES

Introduction

Figure 0.1 Finland's population pyramids in 1950, 2000 ja 2050 (Source: UN)

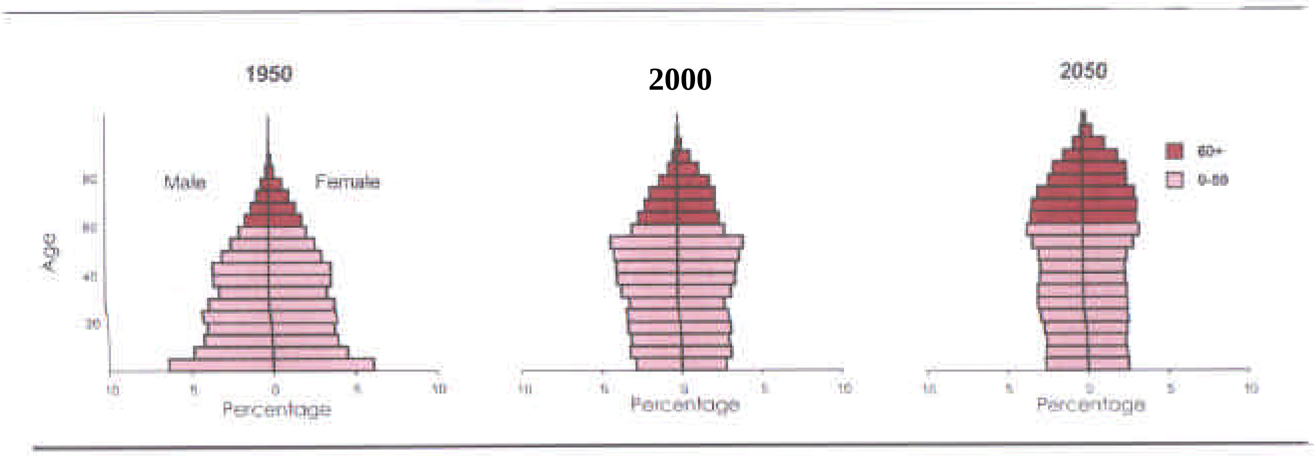


Figure 0.2 Remaining average life expectancy by gender in 1950-2010 (Source: Statistics Finland)

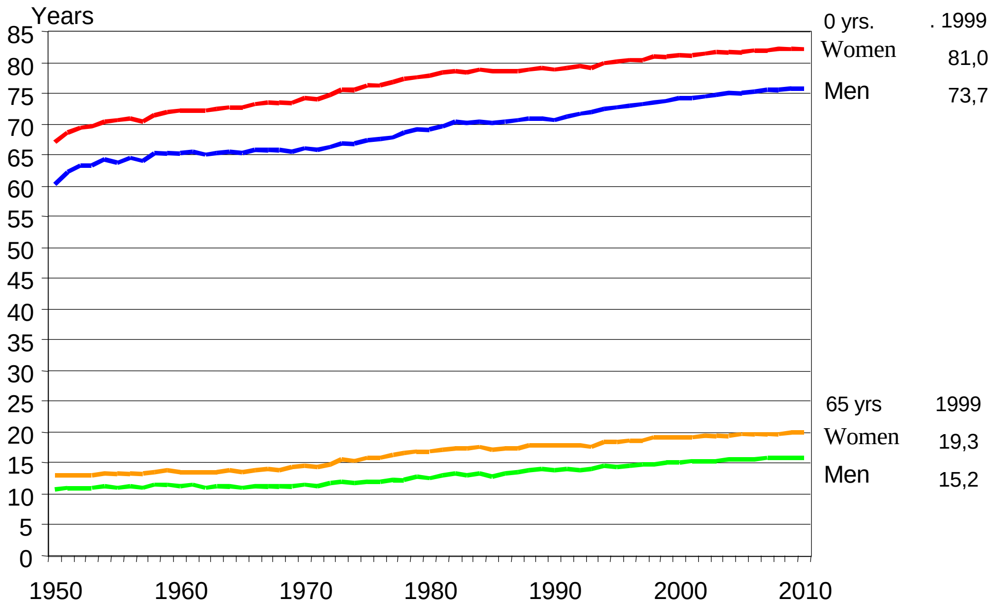


Figure 0.3 Total fertility in 1900 – 2000 (Source: Statistics Finland)

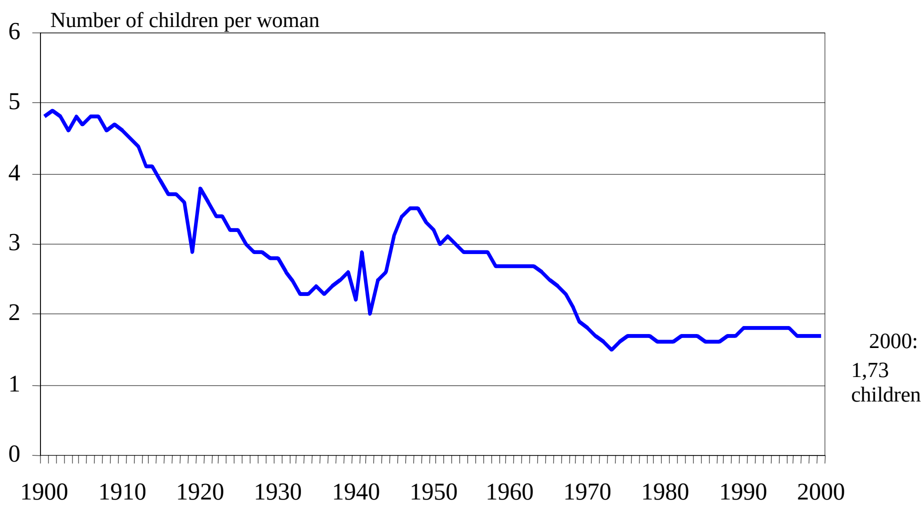


Figure 0.4 Development of the economic dependency ratio in 1970-2050 (Source: Ministry of Social Affairs and Health

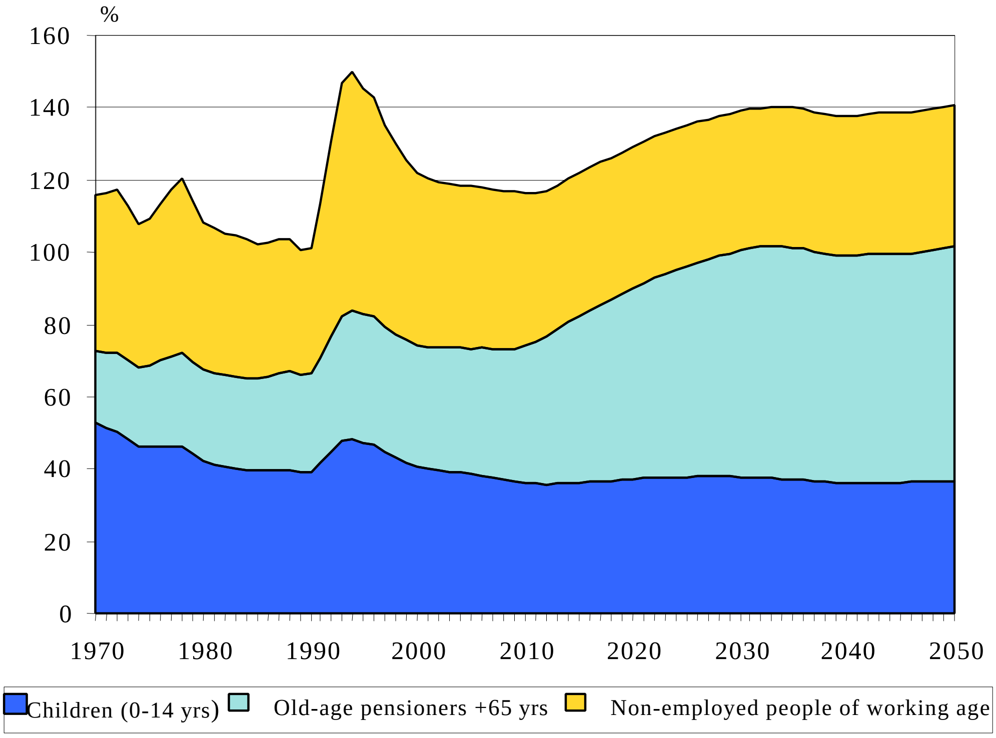
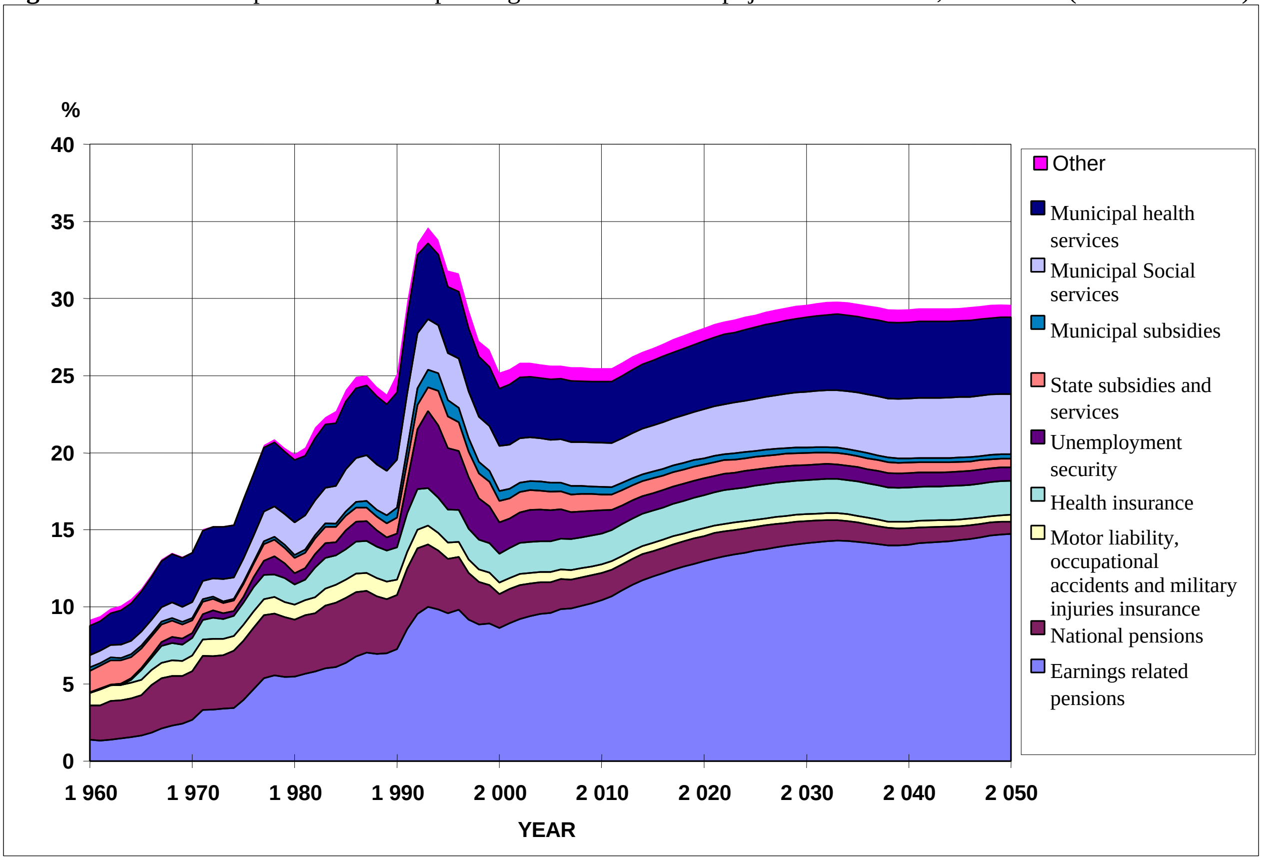


Figure 0.5 Development of social spending in 1960-2002 and pojection until 2050, % of GDP (Source: MSAH)



Target 1

Figure 1.1 Development of the pension indexes in Finland 1962 – 2002, value of 1962=100 (Source: SII)

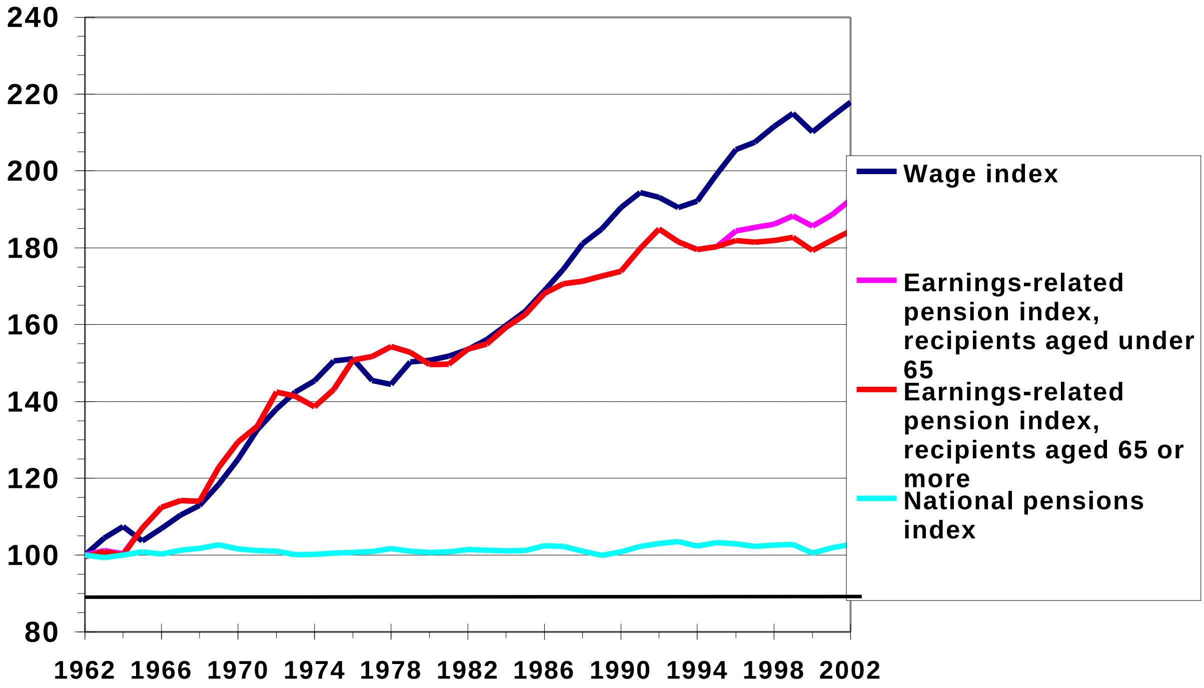


Figure 1.2. Real change in indexes and full national pension in 1962-2002, year 1984=100 (Source:SII)

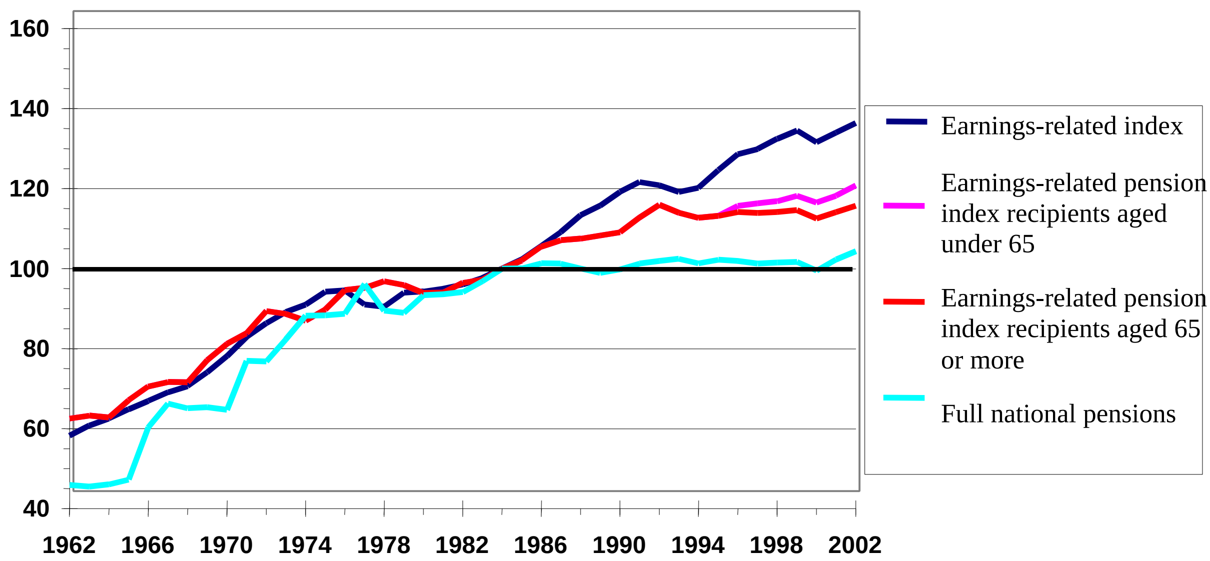


Table 1.1. Income limits for deduction from pension income in euro in 2002 (Source: SII)

	Full deduction from pension income	Annual income entitling to full deduction	Total income from which deduction ceases
Municipal taxation			
Single pensioner	6 540	6 540	15 883
Married pensioners	5 580	5 580	13 551
State taxation			
All pensioners	1 490	1 490	3 619

As consumption unit figure has been used the consumption unit scale recommended by Eurostat, in which the weighting for the first adult is 1, that for the next adults 0.5, and the weighting for children is 0.5.

Table 1.2. Median income (FIM) and relative poverty (50 % and 60 % of median value) in 1990-1999 (Source: Ritakallio, University of Turku)

	- 65 yrs			+ 65 yrs			Total population		
	1990	1995	1999	1990	1995	1999	1990	1995	1999
Md income	82141	83330	97123	57441	68681	75931	79444	81056	94038
Poverty 50	3,1	3,3	4,3	8,6	1,7	3,0	3,8	3,1	4,1
Poverty 60	6,2	7,0	9,6	26,3	9,4	10,9	8,7	7,3	9,8

Table 1.3. Relative poverty among women and men aged 65 years or over (50 % and 60 % of median value) in 1990-1999 (Source: Ritakallio, University of Turku)

	Women + 65 yrs			Men + 65 yrs		
	1990	1995	1999	1990	1995	1999
Poverty 50	15,0	2,8	5,3	3,6	0,8	1,1
Poverty 60	40,0	15,3	15,0	15,4	4,6	7,4

Table 1.4. Poverty rates for older males and females by age group in 1990-1999, % (Source: Ritakallio, University of Turku)

	Man			Woman			Man			Woman		
	65 - 74 yrs			65 – 74 yrs			75 yrs			75 yrs		
	-90	-95	-99	-90	-95	-99	-90	-95	-99	-90	-95	-99
Poverty 50	2,6	1,0	1,2	9,7	2,3	1,7	5,4	0,4	0,8	21,6	3,4	9,0
Poverty 60	12,3	4,7	8,4	21,1	11,0	10,6	34,4	4,4	5,7	46,9	20,1	19,7

Table 1.5. Poverty rates for singles and couples aged 65 or over by gender in 1990-1999, % (Source: Ritakallio, University of Turku)

	Man			Woman			Man			Woman		
	Single			Single			Couple			Couple		
	-90	-95	-99	-90	-95	-99	-90	-95	-99	-90	-95	-99
Poverty 50	10,8	3,3	4,2	16,9	3,2	6,4	1,9	0,3	0,3	3,5	2,0	1,2
Poverty 60	26,4	13,1	21,4	44,6	16,7	17,3	12,9	2,3	4,5	13,9	10,8	8,2

NB! The gender distribution of single older people is very skew. In 1990 older males living alone numbered 56 000 and older females living alone 228 000.

Table 1.6. Households in receipt of social assistance by age of the reference person, % (Source: Pocket information on welfare and health 2002, National Research and Development Centre for Welfare and Health)

Age brackets	**1997**	**1998**	**1999**	**2000**
-29	40	38	37	35
30-49	42	43	42	42
50-64	13	14	16	17
65-	5	5	5	6

Figure 1.3. Distribution of pensioners in different deciles in 1998 (Source: Statistics Finland)

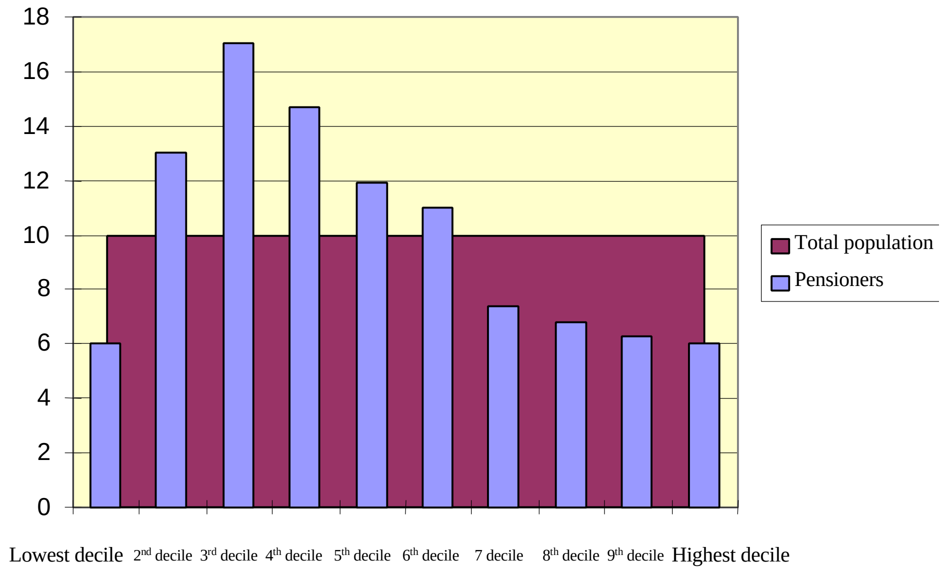


Figure 1.4. Households' wealth in 1998 (Source: Statistics Finland)

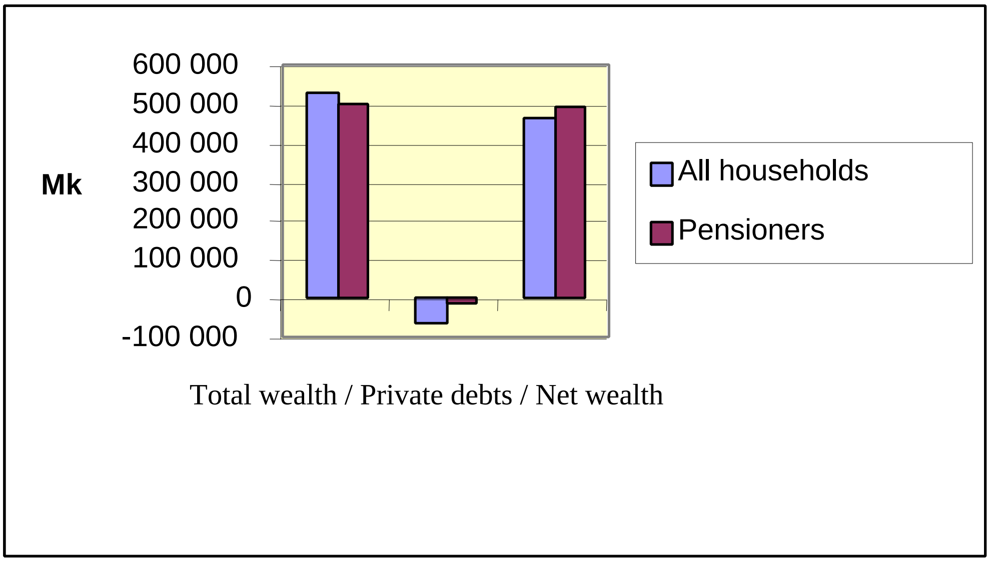


Table 1.7. Average gross wealth and debts of households, and Gini coefficient for wealth according to socioeconomic status in 1998, FIM (Source: Statistics Finland**)**

Socioeconomic status of reference person	**Gross wealth**	**Debts**	**Gini coefficient**
All	**531 000**	**66 000**	**0,5777**
Self-employed	1 083 000	121 000	0,5444
Farmer	1 028 000	49 000	0,4453
Higher salaried employee	845 000	138 000	0,4609
Lower salaried employee	510 000	103 000	0,4946
Worker	380 000	80 000	0,5000
Pensioner	500 000	11 000	0,5628
Unemployed	181 000	19 000	0,7840

Table 1.8. Average gross wealth of households (FIM) by type of household in 1998 (Source: Statistics Finland)

	Single-person household	**Childless couple**	**All households**
Total	**288 280**	**737 220**	**530 770**
- 35 yrs	81 900	290 140	
35-64 yrs	355 750	915 630	
+ 65 yrs	365 590	833 710	

Target 2

Table 2.1. Pension contributions, pension funds and pensions paid in Finland according to the EU division into pension pillars, in ratio to GDP in 1999 (Sources: Insurance Supervision Authority, Ministry of Social Affairs and Health, Federation of Finnish Insurance Companies)

	1st pillar: statutory schemes	*2nd pillar: voluntary collective schemes*	*3rd pillar: voluntary individual schemes*	*Total*
Contributions, % of GDP	*13½*	*½*	*½*	*14½*
Funds at end-year, % of GDP*	*60½*	*3*	*3½*	*67*
Benefits paid, % of GDP	*12*	*½*	*<½*	*12½*

**) 2nd and 3rd pillar: provision for unearned premiums + provision for outstanding claims*

Table 2.2. Shares of incomes, funds and pensions in Finland according to the EU division into pillars in 1999 (Sources: Insurance Supervision Authority, Ministry of Social Affairs and Health, Federation of Finnish Insurance Companies)

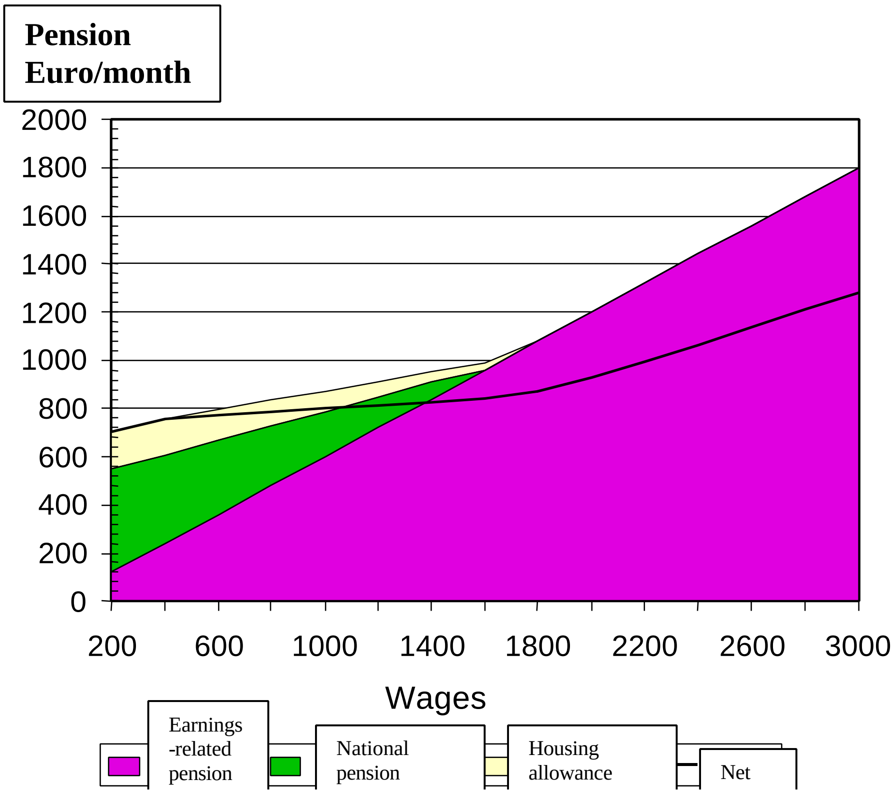
	1st pillar: statutory schemes	*2nd pillar: voluntary collective schemes*	*3rd pillar: voluntary individual schemes*	*Total*
Contributions	*94 %*	*3 %*	*3 %*	*100 %*
Funds at end-year	*91 %*	*4 %*	*5 %*	*100 %*
Benefits paid	*96 %*	*3 %*	*1 %*	*100 %*

Target 3

Table 3.1. Income disparities in 1990-1999 (Gini coefficient) (Source: Ritakallio, University of Turku)

	- 65 yrs			+ 65 yrs			Total population		
	1990	1995	1999	1990	1995	1999	1990	1995	1999
Gini	20,2	22,0	25,8	19,9	19,6	24,8	20,5	21,7	25,8

Figure 3.1. Total pension 1.1.2002 (Source: Central Pension Security Institute)



<u>Target 4</u>

Figure 4.1 Employment rate in 1951-2001 and projection until 2050, % (Source: Ministry of Social Affairs and Health)

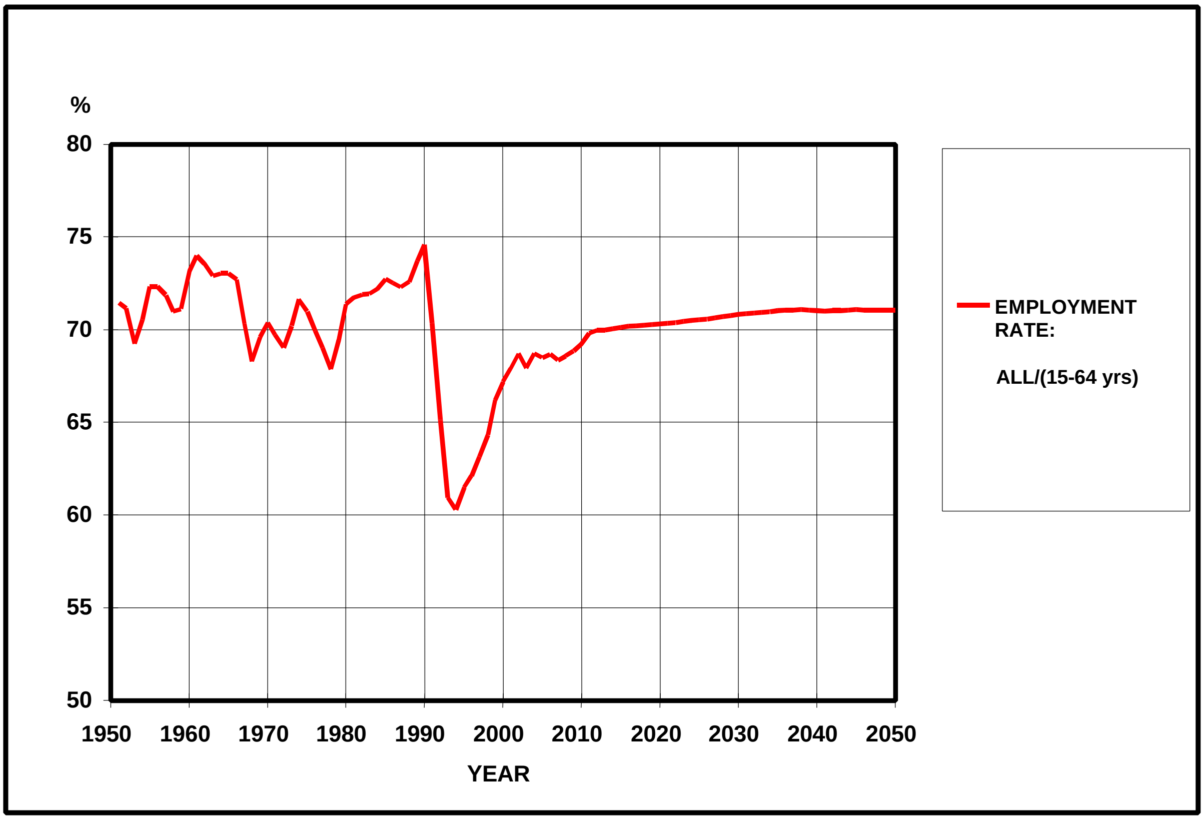


Figure 4.2 Men's employment rates by age group in 1960-2001, % (Source: Ministry of Social Affairs and Health)

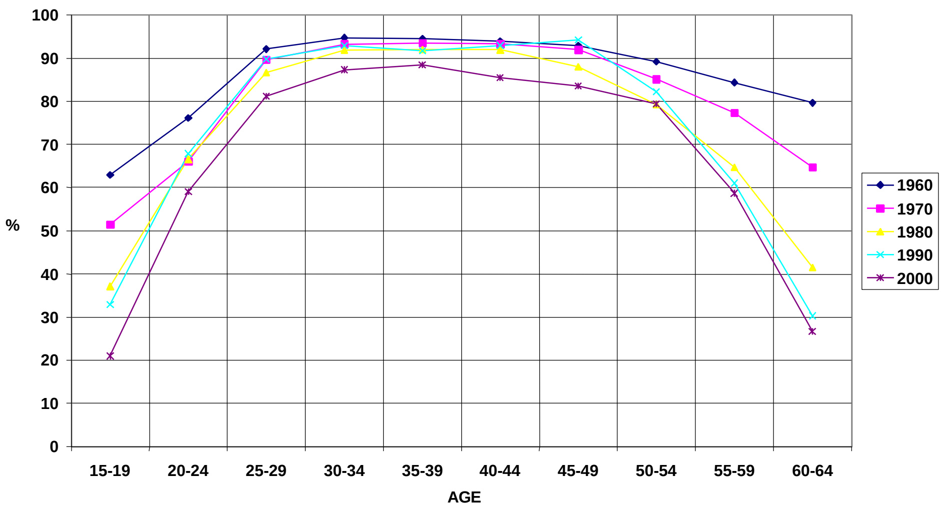


Figure 4.3 Women's employment rates by age group in 1960-2001, % (Source: Ministry of Social Affairs and Health)

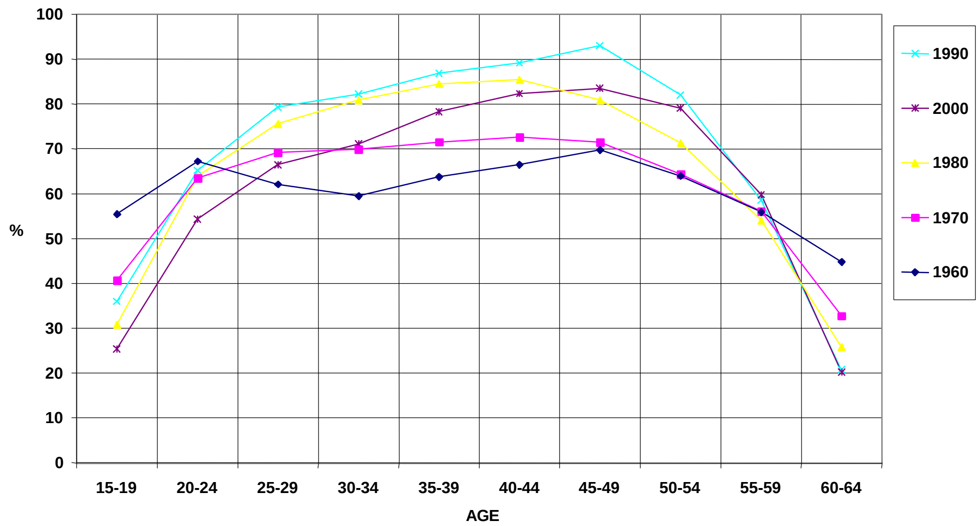


Figure 4.4 Main activity of those aged 45-64 years on 31 December 1999 (Source: Statistics Finland)

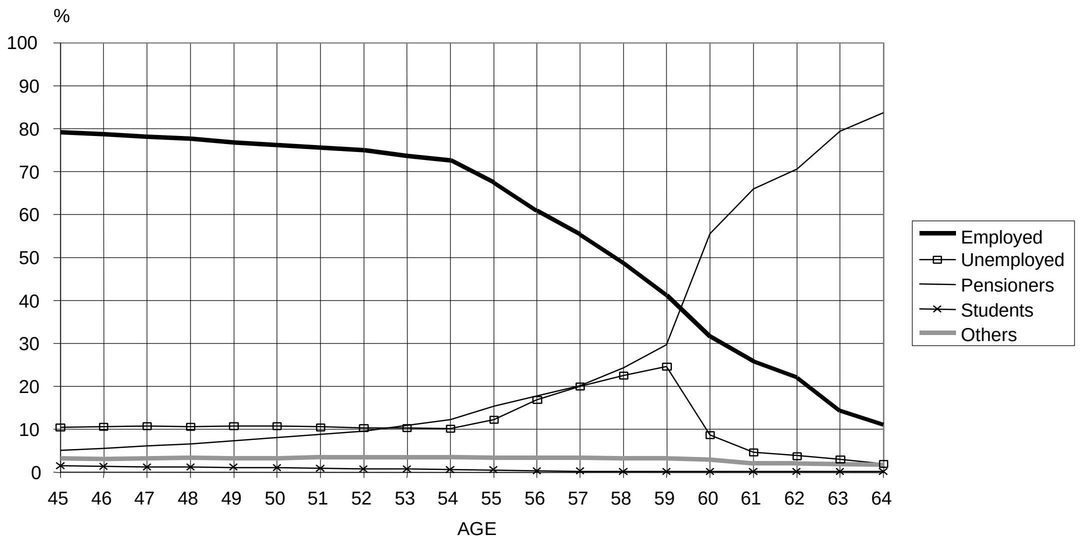
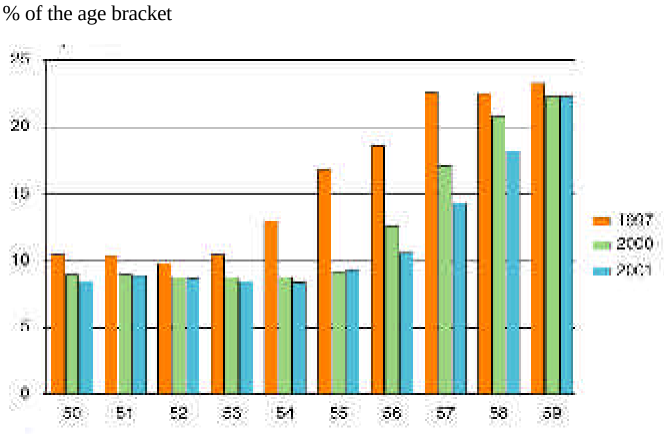
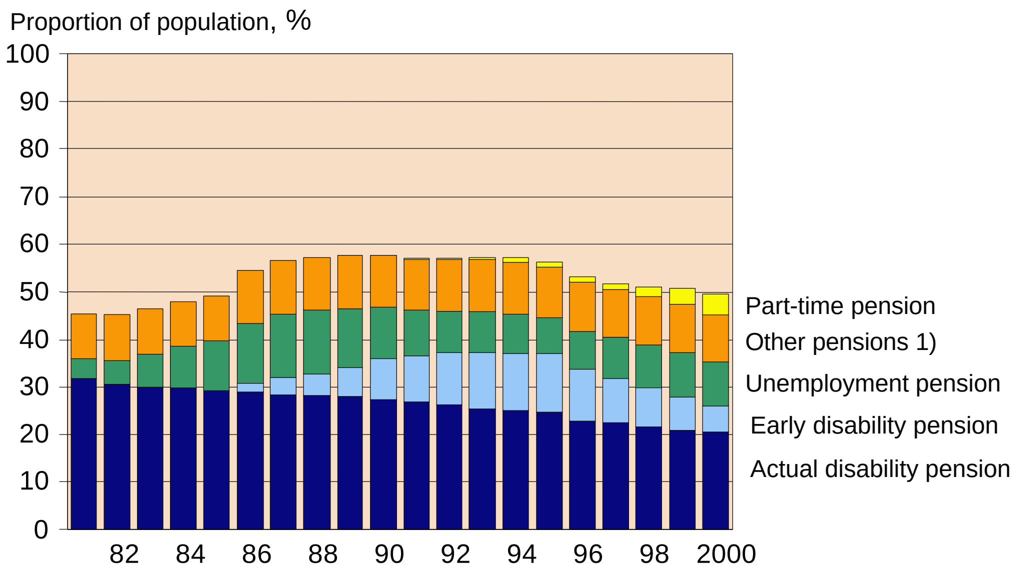


Figure 4.5 Unemployed aged 50-59 years, % of the age bracket in November 1997 and 2000, and in September 2001
(Source: Ministry of Labour)



Target 5

Figure 5.1 Pensioners aged 41-64 years according to type of pension on 31 December 1999 (Source: Follow-up report for the National Programme on Ageing Workers, and Statistics Finland)



1) Old-age pension, special pensions for farmers, front-veterans' pensions

Target 6

Figure 6.1 Deviation of GDP (%) and GDP share of social spending (percentage points) from the basic calculation when retirement is deferred on average by 1 year/ 2 years (Source: Ministry of Social Affairs and Health)

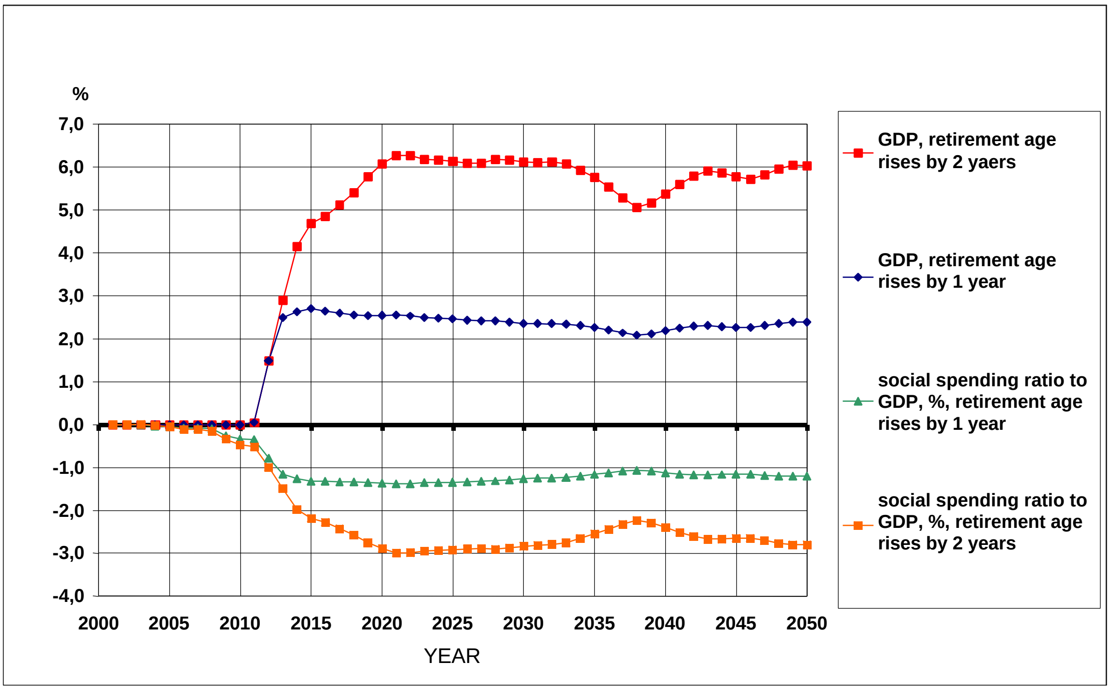


Figure 6.2 Social insurance funds in 1990-2050, % of GDP (Source: Ministry of Social Affairs and Health)
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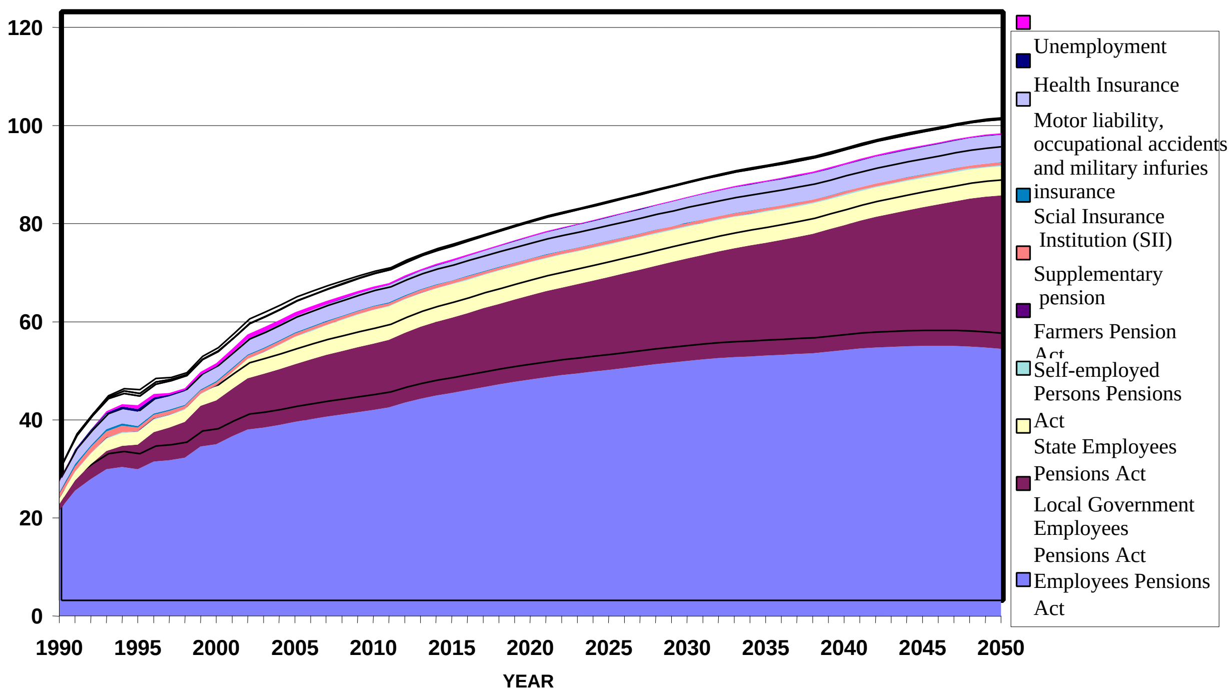
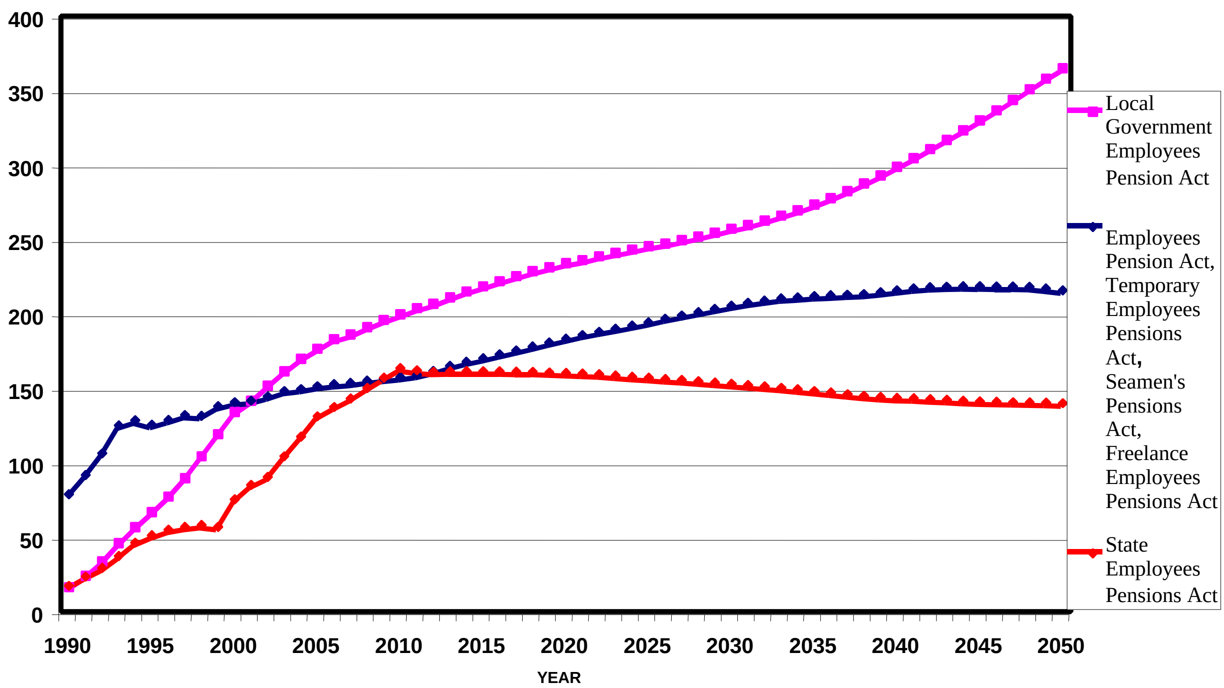


Figure 6.3 Pension funds of the private sector, local government and the state in 1990-2050, % of wages (Source: Ministry of Social Affairs and Health)



Target 7

Table 7.1. Cost-saving impact in 2030 of the changes in pensions implemented in the 1990s

(Source: Central Pension Security Institute)

Year	Changes	Private sector % of wages	Public sector % of wages	% of wages
1996	Pensionable pay	-0,3	-0,7	-0,4
	Projected pensionable service	-1,6	-1,2	-1,5
	Index	-1,4	-1,8	-1,5
	National pension			-0,8
1994	Age limits	-0,7	-1,2	-0,7
	Others	-0,1		-0,1
1993	Public sector reforms		-8,7	-2,7
1990	Reform of survivors' pension	-0,7	-1,2	-0,8
	Total	**-4,8**	**-14,6**	**-8,5**

Figure 7.1. Employee pension contribution as percentage of wages in 1962-2050 (Source: Central Pension Security Institute)

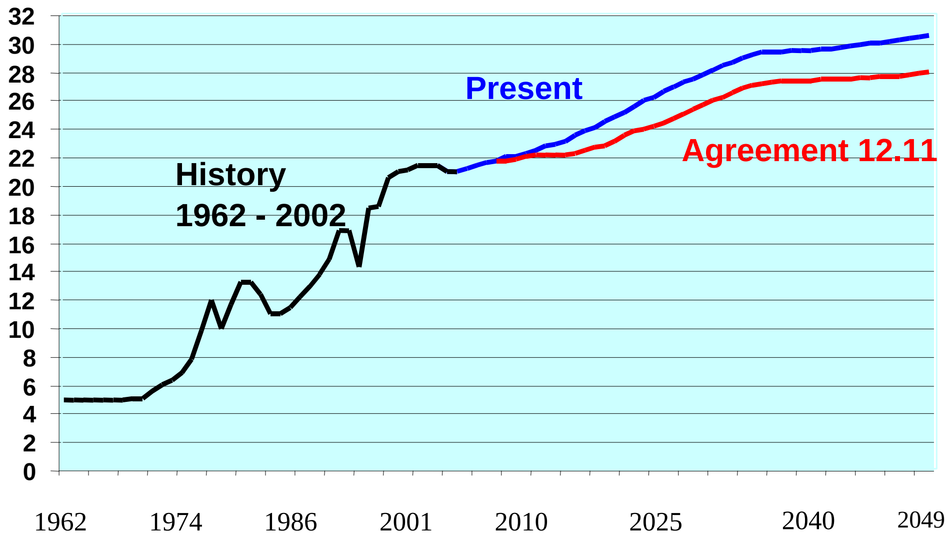
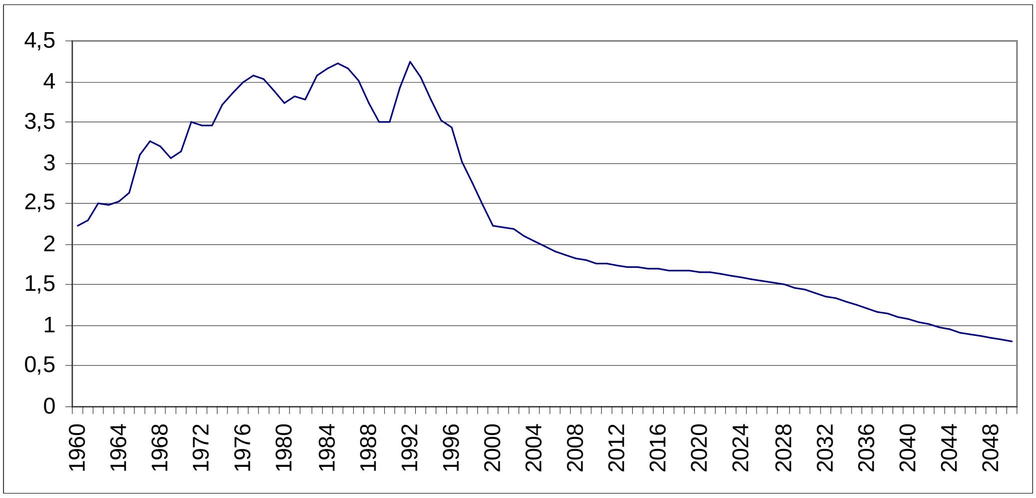
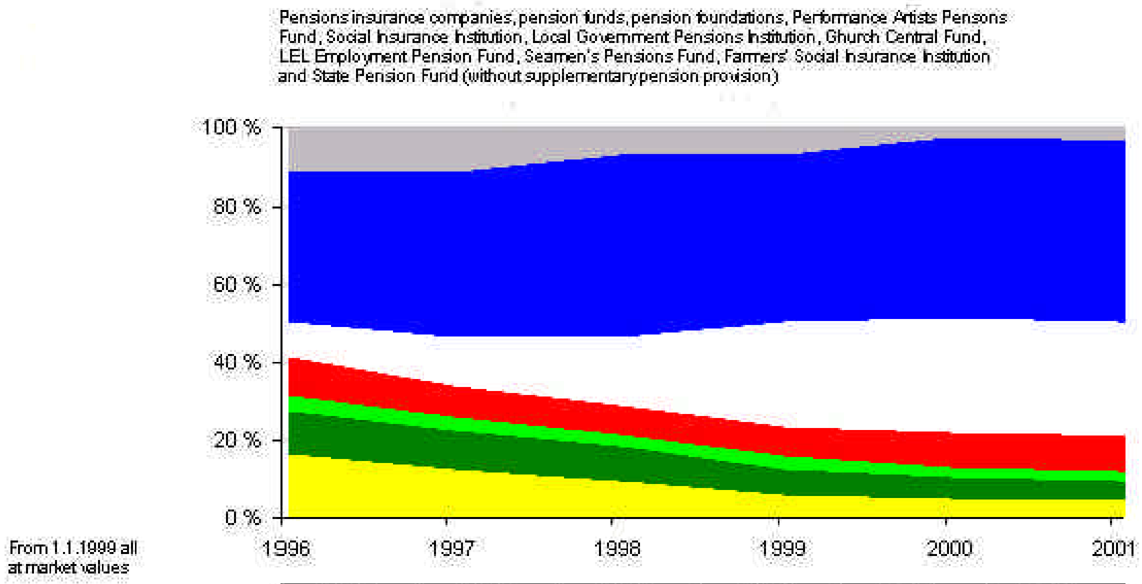


Figure 7.2. Expenditure on the national pension scheme, % of GDP (Source: Central Pension Security Institute)



Target 8

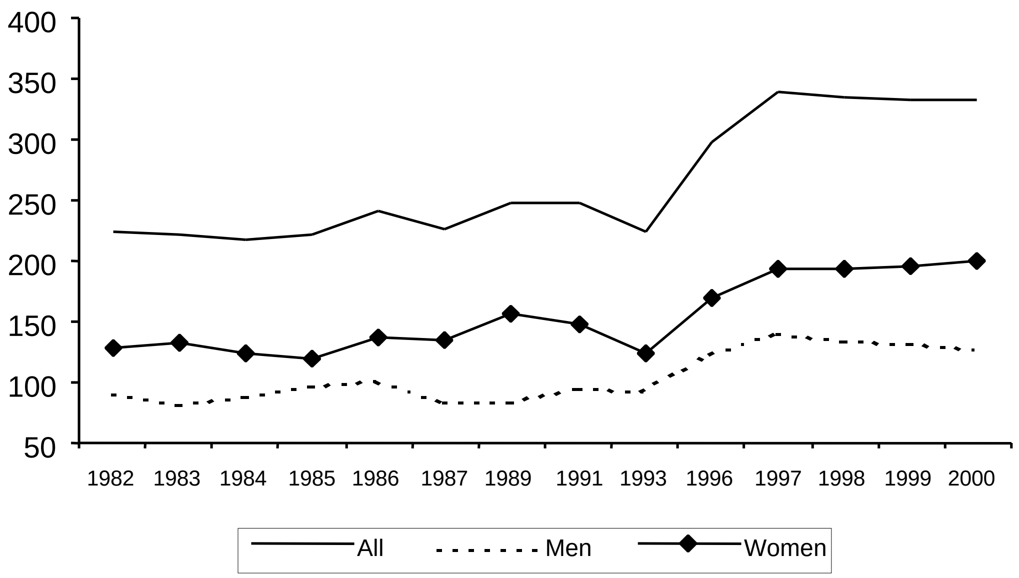
Figure 8.1. Investment portfolio of pension funds in 1996-2001



	31.12.96	31.12.97	31.12.98	31.12.99	31.12.00	31.12.02
MARKET MONEY INVESTMENTS	10,9	11,3	7,0	6,8	2,6	4,0
BONDS	38,4	42,4	46,3	42,9	46,0	46,3
SHARES AND CONVERTIBLE BONDS	9,0	12,4	17,9	26,7	29,3	29,2
REAL ESTATES AND SHARES	10,2	7,9	7,3	7,7	9,2	9,4
LOANS TO OWN COMPANIES	4,0	3,7	3,1	3,1	2,5	2,5
LENDING OTHER THAN PREMIUM LOANS	11,0	9,6	9,0	6,6	5,4	4,1
PREMIUM LOANS	16,5	12,7	9,4	6,2	5,0	4,5

<u>Target 9</u>

Figure 9.1 Fixed-term employment contracts in Finland, 1000 persons (Source: Kauhanen 2001)



SURVEY

MAIN FEATURES OF THE FINNISH PENSION SYSTEM

The main objective of the Finnish pension system is to ensure that the whole population is covered against the social risks caused by old age, disability and death of a family provider. The statutory pension system (i.e. the first pillar pension system) comprises an earnings-related pension scheme and a national pension scheme. The system is obligatory to the whole population. The earnings-related pension scheme provides earnings-related and insurance-based pensions and the national pension scheme a complementary minimum pension on the basis of residence in Finland. These two pensions together form the total statutory pension of a pensioner. In addition, the pensioner could complement the statutory pension with voluntary pension insurance, but this is not common in Finland.

The purpose of the earnings-related pension is to guarantee that the consumption potential attained during the working career is maintained on appropriate level after retirement. The scheme covers all gainfully employed persons and consists of several pension laws. The main laws have been enacted for private sector employees and for the public sector. The most important single act is the Employees' Pensions Act. There are also similar laws for self-employed persons, farmers and some other groups of employees. The public sector's pension schemes are different for the State officials on the one hand and for the municipal officials on the other hand. The basic entitlements and benefits are similar in the different laws, however.

In 2001 employees took part in financing their earnings-related pensions by a share of 4.5 per cent of wages and employers by, on average, 16.6 per cent of the wages paid by them. Partial financing out of general tax revenues is used in some special arrangements, as for seamen's, farmers' and self-employed persons' pensions. The major part of the earnings-related pension insurance contributions is spent on financing the pensions that are already being paid. The benefits and their levels and adjustments to them are decided by Parliament and defined in relevant laws. The Government confirms the basis of the pension contributions annually upon an application of the employee pension institutions. The administration and financing of the earnings-related pensions scheme for the private sector is to a major extent in charge of private insurance undertakings. The purpose of the partial funding of earnings-related pensions – about 25 per cent of the pensions are funded – as well as of the cuts in pension expenditures made in the 1990s is to prepare for future pressures to raise insurance contributions owing to the change in age structure and increased life expectancy.

The purpose of the national pension scheme is to guarantee a minimum pension to all residents in Finland. It is accorded to the pensioners who receive no other pension or whose earnings-related pension is less than about € 1,000 a month, the exact limit depending on the person's marital status and place of residence. The amount of the national pension is proportional to the length of residence in Finland. The full amount (€

467 - 487 per month in 2002) of a person’s national pension depends of his or her marital status and the cost-of-living category of the municipality of residence (municipalities are divided into two cost-of-living categories). To be entitled to a full national pension the person must have been resident in Finland for at least 40 years after the age of 16.

An earnings-related pension reduces by degrees the payable national pension. This co-ordination of pensions ensures that national pension is only paid to those really in need of it. In the present situation most beneficiaries receive pension from both the national pension and the earnings-related pension schemes. Solely national pension is paid to 10 per cent of all pensioners. The national pensions are financed out of employers’ contributions, which are based on the amount of the wages and salaries paid by them, and out of general tax revenues on pay-as-you-go basis.

In international comparison the Finnish pension scheme has resulted in a fairly equal income distribution among pensioners. Although some pensioners may have big earnings-related pensions in terms of money, the steeply progressive income taxation efficiently evens out the income level of pensioners.

***

The statutory pensionable age is 65 years. Early retirement is possible from the age of 60. However, one of the main features of the Finnish pension system and consequences of the favourable pre-retirement schemes is that the effective average retirement age has been about 59 years since the end of the 1980s.

An old-age pension starts to accrue from the age of 23 at the rate of 1.5 per cent per year of every gainful employment relationship that lasts at least one month. From the age of 60 the accrual rate is increased to 2.5 per cent per year of employment. On certain conditions pension also accrues for employment relationships shorter than one month. For a self-employed person earnings-related pension accrues for entrepreneurship that has continued for at least four months. The pensionable wages on which the pension is based are calculated by taking into account the average earnings over the last 10 years, separately for each different employment relationship. There is no upper limit on the earnings that constitute the basis for the pension, but the total pension may not exceed 60 per cent of the highest wages for an employment relationship that has lasted at least one year.

The earnings-related pensions under payment are adjusted annually on 1 January. The accrued pension rights and the pensions of those under the age of 65 are adjusted in line with an index in which changes in prices and wages have the same weighting. Pensions of those over the age of 65 are adjusted by an index in which changes in prices have a weighting of 80 per cent, whereas changes in wages have a weighting of 20 per cent.

The full amounts of national pension are raised yearly to equal to the increase in prices, which guarantees that its purchasing power is retained. From time to time the rate of national pensions is increased by separate decisions. Thanks to the national pension, the level of the total pension cover of people on lowest incomes is high in relation to their wages.