Finland: Pension reforms in Finland

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1. Introduction

Like most OECD countries, Finland has reformed its pension system in recent decades. It has introduced a few major reforms and a number of smaller adjustments in its pension schemes since the early 1990s. In this respect, Finland is no exception, but more uncommonly, the changes have been solely concentrated within first pillar pensions. Unlike in many other countries, where the reforms have resulted in a greater role of occupational and private pensions, recent reforms in Finland have strengthened first pillar pensions, making their role even more important[1]. Between the early 1990s and the end of the 2010s, which is our period of examination in this chapter, many changes have occurred. However, the basic structure and the principles of the pension system have remained nearly unchanged. The reforms in the Finnish pension system have been

[1] Mikko Kautto, 'Reforming Pensions in Finland, Multi-pillar Stability in the Context of Changes within the First Pillar' in David Natali (ed), *The New Pension Mix in Europe. Recent reforms, Their Distributional Effects and Political Dynamics* (P.I.E. Peter Lang 2017)

mainly incremental and parametric and have exemplified considerable path-dependency[2]. The system remains rather unique, with a high coverage and a dominant role of the public mandatory pension provision.

Finland is also an exceptional country in terms of ageing population. The baby boomer cohorts were born in large numbers within a short period of time and at an earlier phase than anywhere else in Europe[3]. Finland is thus the first European country experiencing the demographic and labour market changes caused by baby boomers. Given this, securing financial sustainability has been a key concern and important driver of pension reforms during recent decades. Nonetheless, the question of the social sustainability of pension provision has become increasingly important. A rapidly ageing population has put pressure on renewing the system and the reforms have introduced cost-containment measures, limits to early retirement and means of adapting to increased longevity. In many ways, the Finnish experience can offer valuable insights for countries tackling similar issues.

This chapter provides a review of pension reforms implemented from the early 1990s to the present day. Because of its dominant role, the focus will be on the first pillar pensions, yet the changes in the second and third pillar pensions will be described, too. The chapter thus provides a description of pension reforms introduced to the earnings-related and the national pension schemes. Together, both schemes provide pensions not only in old age, but also in case of disability and the death of a family wage earner. However, we limit our focus to old-age pensions, including the main changes in early retirement pensions.

Pension reforms in Finland can be divided into three waves based on their main aims and timing[4]. While the first wave in early 1990s concentrated on cost-containment leading to retrenchment, the second wave around 2005 was more about modernizing the earnings-related scheme. The third, most current wave, in turn, mainly adapts to the increasing longevity. We will describe the main lines of development accordingly. Before that a short history of the Finnish pension system and a portrayal of the present system is laid out. After

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[2] Karl Hinrichs and Olli Kangas, 'When Is a Change Big Enough to Be a System Shift? Small System-shifting Changes in German and Finnish Pension Policies' [2003] Social Policy & Administration 573; Olli Kangas, Urban Lundberg and Niels Ploug, 'Three Routes to Pension Reform: Politics and Institutions in Reforming Pensions in Denmark, Finland and Sweden' [2010] Social Policy & Administration 265

[3] Antti Karisto, 'Finnish Baby Boomers and the Emergence of the Third Age' (2007) 2 International Journal of Ageing and Later Life 91.

[4] *Kautto* (n 1)

the description of the main reforms, we provide insights into the development of pension expenditure, pension levels and effective retirement age over the period of examination. The final section concludes by discussing the main characteristics of the Finnish pension reforms over the past 25 years, their outcomes in terms of financial and social sustainability and the key challenges the system is most likely to face in upcoming years and decades.

2. A short history of Finnish pension policy and the present system

2.1. The origins and main characteristics of the Finnish pension system

Finland was a late-comer in pension policy. The first pension scheme was introduced in 1937. However, regarding the establishment of an earnings-related pension scheme to top up the basic pension, Finland belongs to the early birds[5]. Finland legislated for an earnings-related pension scheme in the early 1960s for private sector employees, while public sector employees had had their own scheme for decades. The introduction of the earnings-related pension scheme was an outcome of political struggle and compromises. The political debate on pension policy at that time revolved around those supporting a basic pension scheme and those in favour of developing an earnings-related pension scheme. After the Social Democratic Party allied with the Conservative Party and the Employer Federation, supporters of employment-based scheme won, and a statutory earnings-related pension scheme was legislated.[6] In unison, the keystones of the scheme were laid down. A decentralised scheme was established where earnings-related pensions were run by private insurance companies and foundations. Further, its internationally distinct decision-making mechanism was set; the employers' and employees' central labour market organisations were to participate actively in decision-making re-

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[5] Karl Hinrichs, 'Elephants on the move. Patterns of public pension reform in OECD countries' [2000] European Review 353

[6] Olli Kangas, 'Finland: Labor Markets Against Politics' in Ellen M. Immergut, Karen. M. Anderson and Isabelle Schulze (eds), *The Handbook of West European Pension Politics* (Oxford University Press 2007)

garding the earnings-related pension scheme. Therefore, the decision-making is corporatist rather than parliamentary and the earnings-related pension system is often regarded as one of the hallmarks of Finnish corporatism[7].

The Finnish pension system consists of a mandatory earnings-related employment pension scheme (later referred to as earnings-related pension scheme) for the employed and a national pension scheme (national and guarantee pensions) that provides basic security for those who do not have any pension income or whose earnings-related pension is too low to satisfy the minimum income standard. These schemes together form the first, public pension pillar. Finland's pension system is somewhat unique because of the dominant role of the first pillar pensions and the modest, nearly negligible role of the occupational and private pension schemes. The statutory earnings-related pension scheme is said to be the backbone of the Finnish pension system[8]. It is characterized by a virtually universal coverage and nearly uniform entitlement rules without any ceiling on pensionable earnings or pensions. Since the earnings-related pension scheme covers practically all types of employment, operates without any ceilings and provides a reasonably high replacement in old age, the role of second pillar employer-specific occupational pensions and private pensions has remained marginal in Finland[9]. Their role has remained very limited despite many changes that have been implemented into first pillar pensions over the years.

The Finnish public pension system is in many ways unique. The earnings-related scheme is characterized as a functional hybrid incorporating elements both from the first and the second pillars[10]. Together with the national pension scheme, the system represents features of both the Nordic encompassing model and the Continental European corporatist model[11]. The corporatist orientation stems from the decentralized nature of the pension system, while the encompassing orientation relates to basic pension security provided for all[12]. The

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[7] *Kautto* (n 1)

[8] Axel Börsch-Supan, *The 2005 pension reform in Finland* (Finnish Centre for Pensions 2005)

[9] Olli Kangas and Päivi Luna, 'Finland: from the public dominance towards private schemes' in Bernhard Ebbinghaus (ed), *Varieties of Pension Governance: Pension Privatization in Europe* (Oxford University Press 2011)

[10] *Börsch-Supan* (n 8); Bernhard Ebbinghaus, 'The Changing Public-Private Pension Mix in Europe: From Path Dependence to Path Departure' in Bernhard Ebbinghaus (ed), *The Varieties of Pension Governance: Pension Privatization in Europe* (Oxford University Press 2011)

[11] Walter Korpi and Joakim Palme, 'The Paradox of Redistribution and Strategies of Equality: Welfare State Institutions, Inequality, and Poverty in the Western Countries' [1998] American Sociological Review 661

[12] *Hinrichs and Kangas* (n 2)

earnings-related pension scheme incorporates many of the features attached normally to second pillar schemes. The scheme is statutory but provided by several private pension insurers. The administration displays a high degree of corporatism, as social partners (the labour market organisations of the employees and the employers) have a key role in it. Concurrently, the financing method reflects a hybrid nature; the earnings-related pension scheme is financed mainly as pay-as-you-go but it is also partly funded. This unique design is considered as one of the key factors in reform capability[13].

2.2. The statutory pension system

The Finnish statutory pension system consists of three schemes: the mandatory employment-based earnings-related pension, the non-contributory residence-based national pension and the guarantee pension. The national and guarantee pensions aim at ensuring basic income security and protecting against poverty. The targets of the earnings-related pension are income smoothing, and to a reasonable degree, maintaining the income level achieved during the working career. Earnings-related pensions are managed by private pension companies and funds and are financed by contributions from both employers and employees. The scheme is partly funded, and the pensions are defined-benefit (DB). The national and guarantee pensions are tax-financed and are administrated by the Social Insurance Institution (Kela) under the Parliament.

The *earnings-related pension* scheme covers those in gainful employment, including also the self-employed. The limit for the mandatory insurance is very low with €60.57 per month (in 2020). There are different employment pension acts for different sectors (private- and public-sector workers, self-employed, seafarers and farmers). After the reforms of the 1990s, the differences between pension laws have mostly been abolished and nowadays they provide virtually identical benefits and conditions of receiving benefits. The scheme does not hinder labour mobility, because the pensions of workers in different sectors are basically the same and the accumulated pensions are transferable regardless of the employer[14]. The accrual rate is 1.5 per cent of the gross annual earnings as of age 17 until the age that insurance obligation ends. For those born 1957 and earlier, the age is 68. The earnings-related pension is annually uprated with the earnings-related pension index (the share of change in price level is 80 per cent and the share of wage-earner's income level is 20 per cent).

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[13] *Kautto* (n 1)

[14] Nicholas Barr, *The pension system in Finland: Adequacy, sustainability and system design* (Finnish Centre for Pensions 2013)

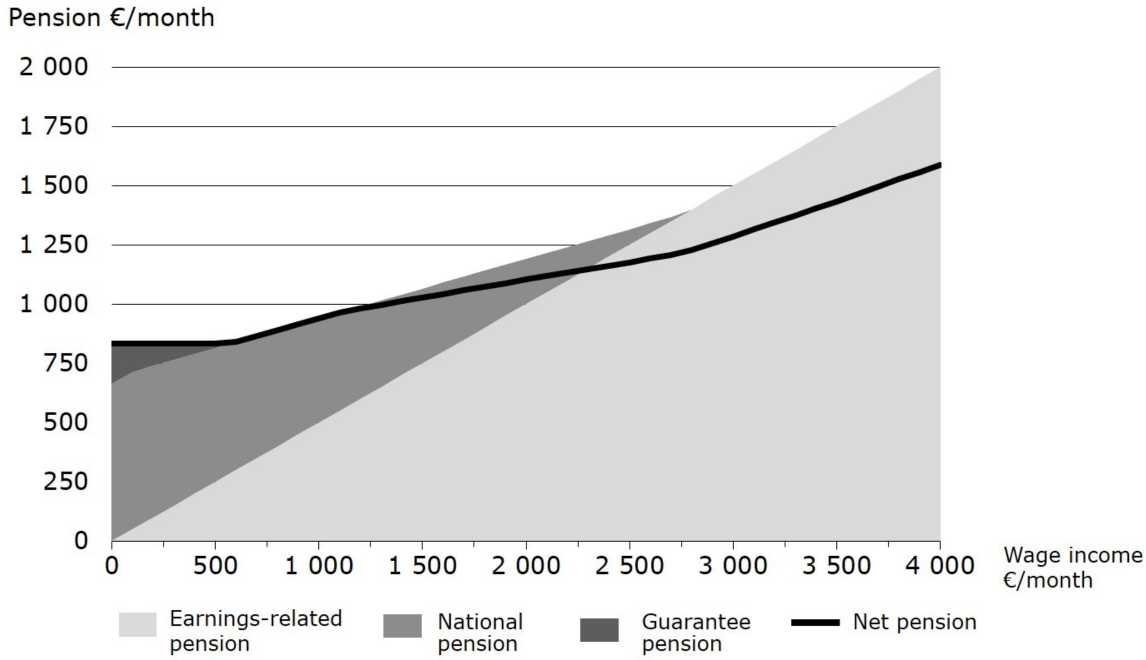
The level of earnings-related pension is adjusted with the life expectancy coefficient, which is determined for each cohort at the age of 62. The statutory pension age is flexible (in 2020 from 63 years 9 months to 68 years), and the age will rise according to life expectancy from 2030.

The *national pension* covers everyone living in Finland with certain requirements for residence and is withdrawn against pension income from the earnings-related pension. It complements the earnings-related pension scheme and provides a basic pension for those whose earnings-related pension is low due to a short or split working career or low earnings. The amount of national pension is phased out as the earnings-related pension increases. In 2020, pensioners whose earnings-related pension is more than €1,368.21 per month are not entitled to any national pension (for married or cohabiting retiree €1,226.13). The full national pension (in 2020, €662.86 per month) is granted with 40 years residence in Finland as an adult, with pro-rata adjustments for shorter periods of residence.

In March 2011, a *guarantee pension* that guarantees a minimum level of pension income for low-income pensioners was implemented. It aims to fill the holes in coverage of the national pension for example for immigrants. The amount of guarantee pension in 2020 is €834.52. When the total gross national and earnings-related pensions amount to less than the lower pension income level stated in the law, the difference is paid in the form of a guarantee pension. Any pension income diminishes the guarantee pension share in full. Approximately eight per cent of all pensioners receive a guarantee pension. National pension and guarantee pensions are updated annually in line with consumer prices. Figure 1 presents the composition of pension benefits at different levels of income.

Figure 1. Total pension income in 2020[15]

[15] Suvi Ritola and Juha Knuuti, *Total pensions in Finland 2020. How are earnings-related pensions, national pensions and taxation determined?* (Finnish Centre for Pensions 2020)



2.3. The role of occupational and private pension schemes

The extensive statutory earnings-related pension scheme has crowded out the occupational and private pensions in Finland[16]. Employers can arrange occupational provision for their employees through either a group or an individual pension insurance. Individuals can take out a voluntary pension insurance or sign a long-term saving contract to have supplementary pension. The registered statutory supplementary pension scheme was established alongside the mandatory earnings-related pension system to cover the needs of those interim cohorts that were not able to accumulate full pensions. As the earnings-related pension system matured, the need for such a registered supplementary pension scheme vanished and in 2001 the scheme was closed.[17]

From the mid-1990s to the mid-2000s the number of private individual pensions grew from 100,000 to 400,000[18], following the government's decision to support private pension insurances through tax deductions. The policy on private pensions altered from the mid-2000s; taxation has been changed and the earliest

[16] *Kangas and Luna* 2011 (n 9)

[17] Marjukka Hietaniemi and Suvi Ritola (eds), *The Finnish pension system* (Finnish Center for Pensions 2007)

[18] *Kangas and Luna* (n 9)

eligibility age has been repeatedly raised. A new form of tax-subsidized long-term saving accounts (PS-accounts) was introduced in 2010. In 2012, the age limit for taking out pension payments from individual pension insurances and from PS-accounts was raised to 68. After that, the sales have in practice ceased[19].

The actual coverage of supplementary pensions is hard to evaluate since a person may have several insurance policies. According to a survey carried out in 2014, 37 per cent of Finns aged 18 to 67 reported that they saved or had previously saved for retirement, be it in the form of a private pension insurance, life insurance, (own-used) real estate or other forms of saving[20]. According to the study, saving for retirement was connected to financial opportunities to save rather than distrust in the statutory pension system. The importance of occupational and private pensions has been measured by comparing the sum values of paid insurance premiums and pensions paid out in different pension pillars. This estimate shows that from 2003 to 2014 premiums paid to occupational pensions and personal pensions remained rather stable, less than one per cent of the wage sum, while their share of pensions paid out slightly increased and equaled 1.4 per cent of the wage sum in 2014[21]. All in all, the role of second and third pillar pensions continues to be very limited despite the adjustments made in the statutory pension system.

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[19] *Kautto* (n 1)

[20] Kati Ahonen and Jyri Liukko, *Private saving for retirement – opportunity or necessity?* (Finnish Centre for Pensions 2016)

[21] *Kautto* (n 1)

3. Pension reforms since the 1990s

In this section we describe the Finnish pension reforms of the past three decades. The focus is first on the reforms of the earnings-related pension scheme that are commonly divided into three waves (Kautto 2017). The first wave of reform occurred in the early 1990s as a savings reaction to macroeconomic shocks and brought along mainly cuts and retrenchment in pension rights. The second wave of reforms culminated in the 2005 pension reform. This, in many ways, modernized the earnings-related pension scheme to cover employees more uniformly and to promote longer working lives with an automatic stabilizer to prepare for increasing longevity. The third wave of reforms has occurred since the turn of the 2010s. The 2017 pension reform fine-tuned the earnings-related pension scheme; it consolidated measures for adapting to increased longevity and for reinforcing the financial sustainability and adequacy of the scheme. In contrast to the earnings-related scheme, the reforms of the national pension scheme do not follow these three waves as clearly, although they also adapt to the reforms of the earnings-related system. The developments of the national pension scheme are described in the last section.

3.1. Reforms of the 1st wave: cost-containment and retrenchment

Pension policy reform began at the turn of the 1990s when Finland fell into a deep recession[22]. Extraordinary economic circumstances created a crisis of conscience that affected opinions on pension policy as well. In addition, the pension committees' reports[23] that appeared at the turn of the decade, had also suggested measures to strengthen the financial sustainability of the earnings-related pension scheme, which was rapidly worsening due to the ageing population. The recession in the early 1990s is regarded as a turning point in the Finnish welfare state, that brought a halt to welfare state expansion and ushered in a retrenchment period. Similarly, the reforms in pension policy meant cuts and cost-containments. Like in many other countries, the

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[22] Jorma Kalela and others (eds), *Down from the heavens, Up from the ashes. The Finnish economic crisis of the 1990s in the light of economic and social research* (Government Institute for Economic Research 2001)

[23] Eläkekomitea, *Eläkekomitean 1990:n mietintö* (Sosiaali- ja terveysministeriö 1991); Eläkekomitea, *Eläkekomitean 1987:n mietintö* (Sosiaali- ja terveysministeriö 1989)

contribution-benefit linkage was tightened, indexing formulae were modified, the age limits for early retirement routes were raised and employees' contributions were introduced[24]. Although reforms at this period were mainly cuts, there were some changes that diverged from this general trend by improving and extending entitlements. For example, a 2.5 per cent accrual rate for those over 60 years was introduced (in 1994) and the age limit for part-time pension was lowered (in 1994 and 1996).

In 1991, an extensive income-policy crisis package was negotiated and as of 1992, employees had to participate temporarily in the financing of earnings-related pensions with a contribution corresponding to three per cent of their wages. Prior to that, the scheme had been fully financed by employers. A year later, the law was made permanent. Simultaneously, it was agreed that in future the changes in contributions would be split equally between employers and employees. Further, it was decided that from 1996 the pension contribution would be deducted from pensionable wages. The changes in the first half of the 1990s brought down expenditure yet meant clear impairments to future pension levels as well as to take-home pay of the current employees. In a longer run, the employees' contribution has increased along with increased contribution rate. While in the early 1990s the contribution was fully paid by the employers and the contribution rate was around 15 per cent, in the late 2010s, the rate equaled on average to 24.4 percent, of which around eight percentage points is paid by employees.

In 1992, the Cabinet also put forward bills on harmonization of public sector pensions and private sector pensions. Historically, pension benefits were better for public sector employees. The rules changed from 1992 onwards for new employees, and in 1994 also for those public sector employees born after 1939. This change was a weakening of pension rights of many public sector employees. However, it also equalized entitlements between private and public sector employees and made the pension scheme by and large more uniform and simpler.

From the beginning of 1996, reforms continued and many significant, piecemeal changes affecting the determination of pension came into force[25]. The amendments were prepared in accordance with the agreement between social partners in May 1995. The first amendment was the lengthened calculation period of pension-

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[24] *Hinrichs* (n 5); Bernhard Ebbinghaus and Dirk Hofäcker, 'Reversing Early Retirement in Advanced Welfare Economies. A Paradigm Shift to Overcome Push and Pull Factors' [2013] Comparative Population Studies – Zeitschrift für Bevölkerungswissenschaft 807

[25] *Hinrichs and Kangas* (n 2)

able income from the median of the last four years to the mean of the last ten years of earnings for each contract of employment. This meant a departure from the final salary principle, particularly for those whose career consisted of more than one contract of employment.

The second amendment concerned the indexation of earnings-related pensions. Until 1995, the index was 50/50 between wages and consumer prices. From 1996, old-age pensions were adjusted with an index split 20/80 between wages and consumer prices. This change was an important cost saving decision and affected the development of pensions and pension expenditure in the long run. It was an exceptional amendment as it affected not only future pensioners, but the current pensioners as well. The reform continues to cause resentment among pensioners and in recent years, there have been several citizens' initiatives on indexing.

In addition, a bill on reforming the national pension came into force in 1996. This transformed the national pension from a universal benefit into an income-tested benefit that is granted only to those who have no or little entitlement to the earnings-related pension. Thus, the abolition of the old principle of universalism, a central characteristic of the Nordic welfare state, gave way to income-relatedness and strengthened the employment-relatedness of the Finnish pension system[26]. Hinrichs and Kangas[27] view the change also as a move towards the Continental European system with a strong emphasis on employment-based benefits. The act was enacted as a cost-saving measure and as a result, the number of those receiving national pension diminished significantly[28].

From the mid-1990s, efforts to decrease early retirement began as well. Age limits were raised for individual early retirement pension (a scheme providing an early exit from the labour market) from 55 to 58 and the so-called unemployment pension tunnel (giving direct access to old-age pension from unemployment benefits for older workers) from 55 to 57. The reforms aiming at deferring retirement and closing early retirement routes also continued in the 2000s.

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[26] *Kangas, Lundberg and Ploug* (n 2)

[27] *Hinrichs and Kangas* (n 2)

[28] Susan Kuivalainen and others (eds), P*ensions and pensioners' economic welfare 1995–2015* (Finnish Centre for Pensions 2017)

3.2. Reforms of the 2nd wave: modernizing the earnings-related pension scheme

The 2005 pension reform brought the most extensive reform of the earnings-related pension scheme in its 40-year history. It aimed at postponing effective retirement age by 2-3 years and to adjust the pension scheme to the average increase in life expectancy. The most notable change was the introduction of a flexible retirement age, where the relatively low age of eligibility was combined with various financial incentives to postpone retirement beyond the age threshold[29]. Furthermore, the reform introduced the life expectancy coefficient, an automatic stabilizer, to adjust the benefit levels to increasing longevity. Moreover, many adjustments were made for the determining of the pension amount. In connection with the reform, early-retirement opportunities were further reduced. Overall, the 2005 pension reform modernized the earnings-related scheme as well as promoted flexibility and financial incentives to work longer.

In line with the reform's aims, the fixed retirement age of 65 became flexible, making it possible to retire on an old-age pension between 63 and 68. Additionally, the accrual rate was changed to be both age-dependent and progressive. From the age of 63 pension accrued at the rate of 4.5 per cent as an incentive to encourage postponement of retirement (the so-called "super accrual rate"). Between 53 and 62, the accrual rate was 1.9 per cent; for persons younger than that 1.5 per cent. The age-based accrual rates were seen to benefit those with a patchy working career[30]. A higher accrual rate at an older age can, on the one hand, profit those having gaps in earlier working career, for example women with career breaks due to childcare. On the other hand, the higher accrual rate in older age profits those with higher earnings at later stages of careers.

In connection with the 2005 reform, the individual early pension and the unemployment pension were abolished and the lower age limits for part-time pension and early old-age pensions were raised by two years. Hence, the reform continued in line with the reforms of the 1990s by restricting access to early retirement pathways. The aim to postpone retirement and to increase labour force participation among older workers was further reinforced by placing a reduction of 0.6 per cent for each month retiring earlier than age 63 (the age for early old-age pension was 62). Furthermore, the reform abolished the cap on the replacement rate. In

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[29] Satu Nivalainen, Sanna Tenhunen and Noora Järnefelt, 'Carrots, sticks and old-age retirement. A review of the literature on the effects of the 2005 and 2017 pension reforms in Finland' [2020] Nordisk Välfärdsforskning|Nordic Welfare Research 83

[30] Eila Tuominen, *Gender mainstreaming in the Finnish pension reform 2005* (Finnish Centre for Pensions 2004)

the old system, the earnings-related pension could not exceed 60 percent of the highest pensionable wage during the career, which created a disincentive to work once this cap was reached. The 2005 reform entrenched many financial incentives for working later and with these “carrots” it aimed to postpone retirement[31].

The reform had also wide-ranging consequences for the importance of the length of working life for benefit calculation. According to the 2005 pension act, the pension was calculated on the basis of the earnings from the entire working career. The change enforced a tighter link between earnings paid and benefits received. Although the 2005 reform is often seen as the moment of withdrawal of the final salary principle, the reform in 1996 had actually already terminated this principle. Simultaneously, the change was regarded as an important step in reducing inequalities, since the length of employment contracts no longer determined the pension income[32].

After the 2005 reform, pension accrued for all employment from the age of 18 instead of previously from the age of 23. Thus, the reform benefited younger generations. It also equalized the minimum age for benefit computation and contribution requirement, since prior to 2005 the contribution had to be paid from age 14 on, although pension accrual started first at 23. After the pension reform in 2005, earnings-related pension accrued more favourably than before both at the beginning and the end of the insured’s working life, and the reform brought more equality in terms of benefit computation and contribution requirement.

Concurrently, the index to covert annual wages to determine the level of pension was changed. While the index was weighted by 50 per cent wages and 50 per cent consumer prices prior to 2005, the proportion was 80/20 from then on. This improved the pension levels and ensured that earnings made at a young age maintain their value better. The index reform also indemnified the potential losses from taking lifetime earnings as the basis for pension calculation. A further improvement was the introduction of accrual for periods of parental leave and during periods of study leading to a degree. Prior to 2005, unemployment and non-working periods lasting less than a year had been covered, but not equally. The reform thus harmonized the provision for pension accrual related to these periods.

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[31] *Nivalainen, Tenhunen and Järnefelt* (n 29)

[32] *Tuominen* (n 30); *Börsch-Supan* (n 8)

To improve financial sustainability and to encourage people to extend their working lives, the 2005 reform introduced the life expectancy coefficient, a mechanism adjusting the level of starting pension in relation to prolonged life expectancy. The coefficient affected pensions for the first time in 2010. Then the coefficient was 0.99170, while in 2020 it is 0.95404. In the future, the effect will increase, and it will be the main factor for declining future benefit levels as working careers are not expected to lengthen enough[33]. The central idea is that by retiring somewhat past the lowest retirement age, people could nullify the reducing effect of the life expectancy coefficient.

After the major pension reform in 2005, some amendments were made in 2007 and 2010 by further harmonizing the coverage of the earnings-related pensions and passing more flexible investment regulation for funded assets. The age limit for part-time pension was increased from 58 to 60 years and the earnings-related contribution was raised by 0.4 percentage points.

3.3. Reforms of the 3rd wave: raising the pensionable age and further adapting to increased longevity

The 2017 pension reform and preceding changes represent the third wave of reforms of the earnings-related scheme. Raising the pensionable age lies at the heart of the reform which aims at extending working lives and raising the effective retirement age to secure financial sustainability of the scheme and adequacy of pensions. While the 2005 reform used incentives to "nudge" people to retire later voluntarily, the 2017 reform relied on peremptory provision to increase the age of retirement, instead of "carrots" it utilized more "sticks"[34]. The 2017 reform introduced new forms of pensions to further promote flexible retirement and to secure pension provision for those engaged in arduous and hazardous jobs. It continued fine-tuning and modernizing the earnings-related scheme with more uniform rules to better meet the needs of upcoming years.

The first step for the latest reform wave took place in spring 2009, when, after the Prime minister announced that the pension age needed to be raised, social partners and the Government agreed that the effective retirement age should be increased by three years by 2025. From 2012, the early old age pension was abolished,

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[33] Heikki Tikanmäki and others, *Statutory Pensions in Finland – Long-term Projections 2019* (Finnish Centre for Pensions 2019)

[34] *Nivalainen, Tenhunen and Järnefelt* (n 29)

and the age limits were raised for part-time pension and for additional days of unemployment security. Social partners also agreed on setting up a pension expert panel and on negotiating a further pension reform.

The agreement between social partners on further pension reform was reached in autumn 2014. It came into effect in 2017. The main objectives of the 2017 pension reform were to reduce the sustainability gap of public finances, extend working life, promote employment, secure pension financing, and ensure adequate pensions and intergenerational equality. The reform brought changes to the pension age, accrual rates and introduced two new pension types.

The most noticeable amendment was the rise in old-age retirement age. The age was set to increase by three months for each birth cohort, starting from those born in 1955, until the threshold reaches 65 years (for the 1962 cohort). Thereby, the lower age limit was returned to where it was before the 2005 pension reform, namely 65 years. The pension age remained flexible, with a five-year span. From 2030 on, the retirement age will be linked to life expectancy, but so that it will increase at most by two months by cohort. The linking is done in a way that the time spent working in relation to the time spent in retirement will remain at the 2025 level. This linking thus introduced another automatic stabilization mechanism in addition to the life expectancy coefficient that was introduced in the 2005 reform[35]. The latter will be calculated in a more lenient manner as of 2027. The 2017 reform also introduced a target retirement age for each cohort. Working until the target age will offset the reducing effect of the life expectancy coefficient.

The reform also standardized pension accrual rates. The age-dependent rates and the 'super accrual rate' were removed and the accrual rate of individuals of all ages was set at 1.5 per cent of wages. Deferred retirement was rewarded with an increment, amounting to 0.4 per cent per deferred month of the pension accrued in addition to the normal accrual rate (1.5 %). In the previous system the 'super accrual rate' was based on current earnings. The new system thus treats people with varied working careers more equally. Furthermore, the employee's pension contribution is no longer deducted from the pensionable income (reform introduced in 1996). This will raise the effective accrual rate and hence the level of future pensions. Moreover, from 2017 onward, pension accrues as of age 17, in contrast to the previous age limit of 18 years, which will improve pension levels of younger generations.

In connection with the 2017 pension reform, two new pension types were introduced. The part-time pension was abolished and replaced by a partial old-age pension. A person can draw either 25 or 50 per cent of the accrued pension at age 61. From 2027, the age limit will rise in line with the old-age retirement age. If the partial old-age pension is drawn before the earliest eligibility age for old-age pension, the pension will be

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[35] OECD, *Pensions at a Glance 2019* (OECD 2019)

reduced by 0.4 per cent each month. The new type of pension has been popular, especially among the self-employed and unemployed. Eight per cent of all those who are eligible have taken a partial old-age pension. The partial pension does not include any restrictions on working hours or earnings. A majority of those who were employed at the time they started to take partial old-age pension also have remained at work.[36] Furthermore, the 2017 reform introduced the years-of-service pension for persons in arduous or hazardous work. It is targeted at people whose work ability is reduced and who have done work that requires great mental or physical effort for at least 38 years. So far, as the lowest eligibility age of the years-of-service pension is 63, it has not yet gained popularity, but in upcoming years, the situation may alter as the overall lowest retirement age rises.

3.4. Changes in national pension scheme

The past three decades have not left the national pension scheme unchanged, either. Instead, the reforms have embedded structural changes altering the role of the national pension scheme. Over the period of our examination, the role of the scheme has transformed from providing basic security to all into securing minimum income to those with insufficient employment history. After the abolishment of employers' national pension contribution in 2010, the national pension scheme has been purely tax-financed and solely under political decision-making.

In 1996, the so far universal national pension became subject to a pension-income test. The reform took place gradually within five years and by 2001 the basic amount was completely abolished. Ever since, the amount provided by the national pension has been fully dependent on a person's earnings-related pension income. In 2011, a new form of targeted pension, the guarantee pension, was introduced. It was seen as an effective way to secure the livelihood of pensioners, since it was targeted only at pensioners with the lowest income and also better covered those who were not previously covered, e.g. immigrants. The introduction of the guarantee pension increased the relative level of the minimum pension quite considerably, namely by 17 per cent for single households[37].

[36] Sanna Tenhunen and others, *Who opts for a partial old-age pension? A study on the factors behind the choice to take early payment of a partial old-age pension* (Finnish Centre for Pensions 2018)

[37] Ilpo Airio and Minna Nurminen, 'The case of the guarantee pension reform: change of perceived income adequacy among low-income pensioners in Finland' [2016] European Journal of Social Security 248

Overall, the policy on the level of the national pension scheme has varied over the past 20 years. In the 2000s, the amount of national pension was increased several times (2001, 2005, 2006 and 2008). By contrast, between 2015 and 2019, the amount of national pension was cut, as the regular annual price indexing was either limited or frozen altogether. However, at the same time the amount of guarantee pension was subject to several general increases (2016, 2018 and 2019). The levels of national pension and guarantee pension thus developed differently and benefited those with the lowest pension income. As of 2020, both the full amount of the national pension and the guarantee pension were raised, the national pension by about €34 and the guarantee pension by €50 per month. This is in line with the aims of the current government program to protect income security and reduce poverty among older people.

All in all, the national pension scheme has lost importance over the past two decades due to the maturation of the earnings-related statutory pension and partly due to pension-income testing in basic pensions. An increasing share of retirees have accrued higher levels of earnings-related pensions, and a smaller share is in need of complementary basic pensions. In 2002, 54 per cent of all pensioners received national pensions, while in 2018, the share was 39 per cent. At the same time, the importance of the earnings-related pension scheme has increased.

4. Achieving the goals of the reforms: Changes in expenditure, adequacy and effective retirement age since 1990s

The main goals of recent pension reforms in Finland – as in many other countries – have been curbing public expenditure for pension provision, extending working lives and at the same time, securing adequate pensions. In this section, we look at the development of selected measures of assessing how the pension system relates to these key objectives of past reforms by describing the development of pension expenditure, average level of pension benefits and retirement age over the period of examination. These are also commonly used measures by OECD[38] and European Commission on this topic[39].

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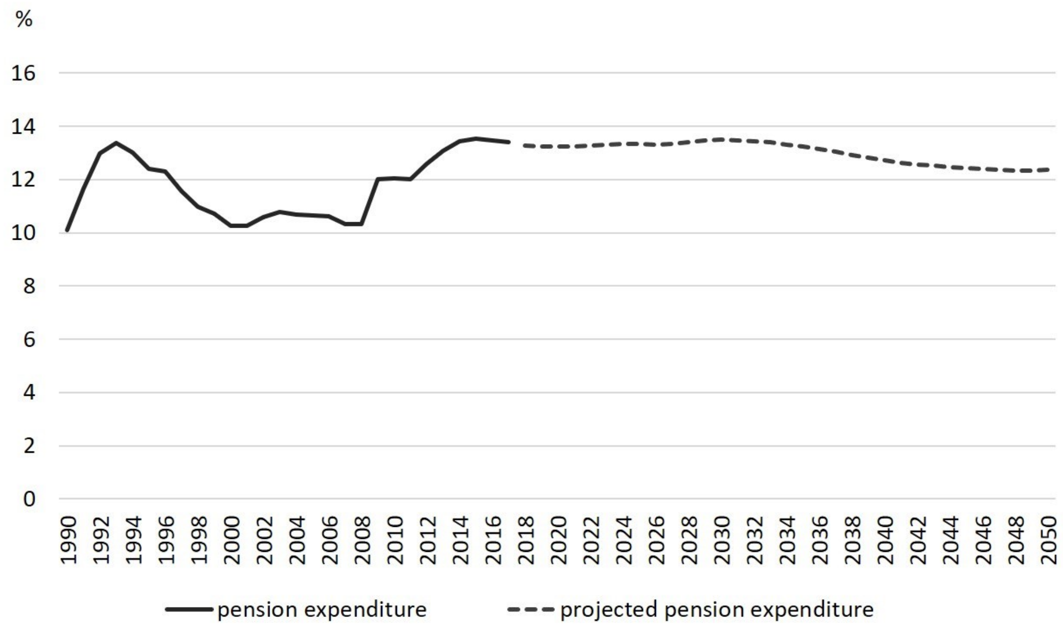
[38] *OECD* (n 35)

[39] European Commission, *The 2018 Pension Adequacy Report: current and future income adequacy in old age in the EU* (European Commission 2018)

4.1. Pension expenditure

Figure 2 shows the statutory pension expenditure relative to GDP from the early 1990s to 2017 and the projected ratio from 2018 to 2050. In 1990, the ratio was around ten per cent. During the deep economic recession of the early 1990s the statutory pension expenditure relative to the GDP increased. From the mid-1990s to 2008, the ratio remained under 11 per cent, as the rapid economic growth kept the expenditure ratio at a stable level despite the ageing population. Since 2008, the expenditure ratio has increased quickly due to the baby-boom generation having reached retirement age. In 2017, statutory pension expenditure amounted to 13.4 per cent of GDP and is slightly above the EU27 average[40].

Figure 2. Pension expenditure relative to GDP from 1990 to 2017 and projected ratio from 2018 to 2050[41]



[40] ibid.

[41] *Tikanmäki and others* (n 33); *Statistical databases of Finnish Centre for Pensions and Statistics Finland*

The ratio of pension expenditure to GDP is projected to remain close to its current level until 2030. After that, the growth in the number of pensioners will slow down, which will decrease the pension expenditure relative to GDP.[42] In many EU member states, public pension expenditure is projected to increase, and the average increase equals 0.8 percentage points of GDP between 2016 and 2040, while in Finland, the development is expected to be more modest[43]. This is first and foremost due to the life expectancy coefficient as an automatic stabilizer mechanism.

Another way of assessing the financial sustainability of the pension system is to look at pension expenditure in relation to the wage sum (a total of gross wages paid to employees). It demonstrates visibly on the one had why financial sustainability has dominated the pension policy agenda in recent decades and, on the other hand, how pension reforms have managed to moderate the financial pressure. Pension expenditure has increased significantly relative to the wage sum. In 1990, the ratio was less than 15 per cent while in 2018 it reached over 30 per cent. Current expenditure relative to the wage sum is quite similar to the level that was forecasted (for 2018) at the turn of the 1990s. The previous estimations for the year 2030, however, exceed by almost ten percentage points the most recent projection, indicating that pension expenditure relative to the wage sum will be 33 per cent in 2030[44]. This rather large decline demonstrates a noteworthy improvement in the financial sustainability following the series of pension reforms since the 1990s. The projections made for the 2017 reform show that the annual earnings-related pension expenditure relative to the wage sum will decrease due to the reform. In consequence, the pension contribution can be kept at present level (circa 24.4 %) in upcoming decades.[45] Nonetheless, the contributions will remain at a relatively high level in international comparison, demanding continual responsiveness.

4.2. Benefit levels

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[42] *Tikanmäki and others* (n 33)

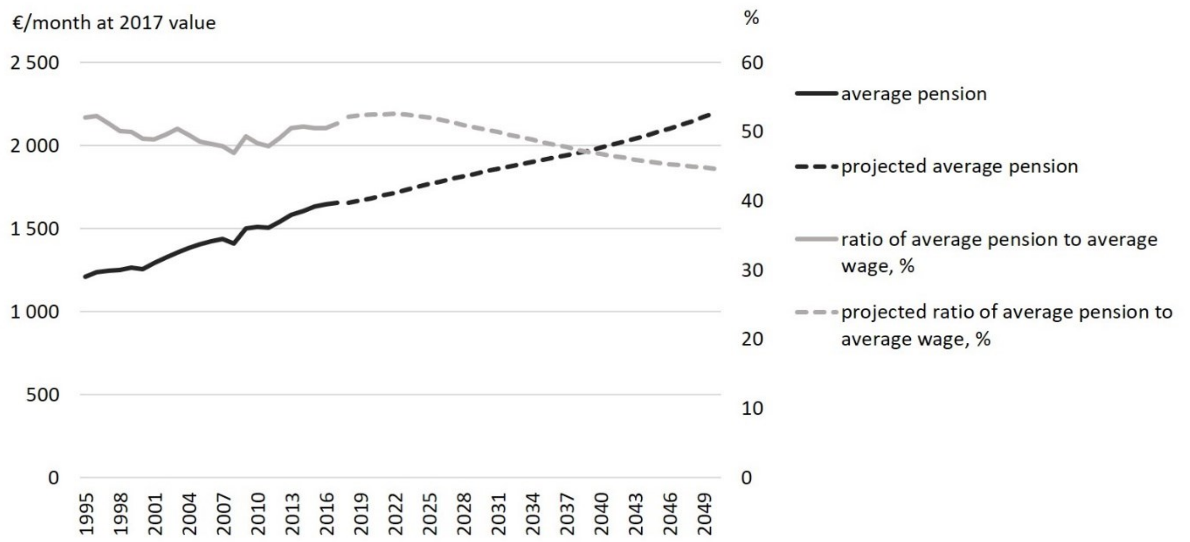
[43] *European Commission* (n 39)

[44] *Kautto* (n 1); *Tikanmäki and others* (n 33)

[45] Kaarlo Reipas and Mikko Sankala, *Effects of the 2017 earnings-related pension reform – Projections based on the government bill* (Finnish Centre for Pensions 2015)

The key aim of pension policy is to provide adequate income security. An essential question is thus how a pension system has fulfilled this function over the past decades and whether there has been any significant change in one direction or another. In other words, while the reforms have achieved better financial sustainability of the pension system, has this happened at the expense of pension adequacy? One commonly used way to assess this is to look at the level of pensions relative to wage income (Figure 3).

Figure 3. The average pension and its ratio to average wage 1995–2017 and the ratio of projected average pension to average wage 2018–2050, at 2017 values[46]



Over the period, the average pension has increased in real terms more than 37 per cent, while the ratio of average pension to employees' average earnings has been around 50 per cent throughout the period. The position of pensioners vis-á-vis the working population has thus remained unchanged. Considering many other adequacy measures, the average economic situation of pensioners has developed favourably during the past 25 years and the pensioners' relative position to the working population and the total population has even improved to some extent in recent years[47]. The Pension Adequacy Report[48] reveals a similar picture. It

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[46] *Tikanmäki and others* (n 33); *Statistical databases of Finnish Centre for Pensions and Statistics Finland*

[47] *Kuivalainen and others* (n 28)

[48] *European Commission* (n 39)

shows that the risk of poverty and social exclusion (AROPE) among people aged 65 and over in Finland is among the lowest in Europe and that it has also declined in recent years.

In the future, the ratio of the average pension to average earnings is protected to decrease, mainly owing to the longevity coefficient introduced in 2005[49]. In a comparison of the future replacement rates in European countries, the decline in the replacement rates is moderate in Finland[50]. The recent OECD Pensions at a Glance report[51] provides parallel results. Finland is among the top one-third of OECD countries when assessing replacement rates in the long-term.

Over the period of examination, the pension benefit level and economic welfare among pensioners have thus developed favourably, and it appears that the pension reforms have not so far eroded pension adequacy. The positive development in the pension levels is largely related to structural changes in the population of pensioners[52]. The evaluation of the 2017 reform indicates that average pensions will grow further[53]. This is mainly due to extended working lives, but also to other factors such as the mitigated life expectancy coefficient. However, due to the reduced time spent in retirement, the reform will reduce the life-cycle pension income.

In future, adequate pensions will increasingly depend on longer working careers. The generation currently working and generations entering the labour market will have to work longer and will receive their pension on weaker terms than older generations. Even though the major pension reforms have improved the coverage and to some extent the benefit levels, they have also brought along less favourable adjustments, namely the measures to adapt to increased longevity. The adequacy of pensions is thus less self-evident in the future, requiring constant monitoring.

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[49] *Tikanmäki and others* (n 33)

[50] *European Commission* (n 39)

[51] *OECD* (n 35)

[52] *Kuivalainen and others* (n 28)

[53] *Reipas and Sankala* (n 45)

4.3. Effective retirement age

Like in many countries, the effective retirement age is used in Finland as a key indicator to monitor the impact of pension reforms and retirement policy. During the past decades, extending working lives, postponing retirement and increasing the employment rate of older workers have become increasingly central goals of pension politics.

Figure 4 shows the effective retirement age from 1996 to 2018. The expected effective retirement age has increased from 58.8 years in 1996 to current 61.3 years. An increase in the effective retirement age was very modest from the mid-1990s to mid-2000s. At the time that the 2005 reform was under preparation, Finland had an effective retirement age around 59 years – six years lower than the official old-age retirement age. This was mostly due to the relative ease of access to early retirement pathways and a prominent culture of early retirement. Since the 2005 reform the effective retirement age has increased by two years. The change is visible in the proportions of new retirees by pension benefit as well. While in the early 2000s, 27 per cent of new retirees started on an old age pension, in 2016, almost 80 per cent retired on an old age pension. Because of the reform, early retirement became far less pronounced than it was before. Despite this, the average effective retirement age in 2018 was still below the OECD-average in Finland[54].

Figure 4. Effective retirement age 1996–2018 and projected effective retirement age 2019–2050[55]

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[54] *OECD* (n 35)

[55] *Tikanmäki and others* (n 33); *Statistical databases of Finnish Centre for Pensions and Statistics Finland*

Source: Statistical database of Finnish Centre for Pensions; Tikanmäki et al. (2019)

Although the 2005 pension reform increased the effective retirement age and people started to retire on an old-age pension instead of early retirement pension, it was noticeable that very few continued to work past the earliest eligibility pension age of 63. From then on, the reform shifted the retirement pattern from 65 towards 63 and age 65 was replaced by 63 as the new "normal" of retirement age. Relabelling the pension age was found to have a very strong effect on retirement, far greater than the financial incentives that the reform introduced[56]. Studies also found that in particular, the reform had encouraged healthy workers to choose earlier retirement[57]. The reform thus failed to encourage people to work past 63, and therefore the 2017 pension reform took a very different approach and instead of relying on financial incentives, it increased the retirement age[58].

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[56] Jonathan Gruber and others, *The Effect of Relabeling and Incentives on Retirement: Evidence from the Finnish Pension Reform in 2005* (Labour Institute for Economic Research 2019)

[57] Taina Leinonen and others, 'Health as a predictor of early retirement before and after introduction of a flexible statutory pension age in Finland' [2016] Social Science & Medicine 149

[58] *Nivalainen, Tenhunen and Järnefelt* (n 29)

The effective retirement age is expected to rise as the effects of the 2017 pension reform begin to show. The projections predict that the reform will further postpone retirement, mainly due to the increases in retirement ages.[59] In 2018, when the retirement age was increased to 63 years and 3 months, many of those born in 1955 continued working at least up to the new retirement age and the effective retirement age increased by 0.1 years[60]. The expected effective retirement age is projected to rise to 62.5 years by 2025 and to 64.5 years by 2050[61].

5. Conclusions

Over the past 25 years, the Finnish pension system has been transformed in many ways. The reforms started in the early 1990s after a deep recession and have continued thereafter with the aim of securing financial and social sustainability and adapting to increased longevity. The implemented reforms and adjustments have streamlined the system, making it more uniform and compact. In many respects, the Finnish pension system has altered, but the core has remained nearly unchanged and the role of supplementary pension schemes, the occupational and private pensions, continue to have a marginal role. The earnings-related pension scheme is now an even stronger backbone of the Finnish pension system with wider coverage and more harmonized rules. The national pension scheme, on the other hand, has played more important role since the mid-1990s in providing basic security to those with insufficient earnings-related pension.

Despite a great many minor and major adjustments throughout the reform waves, the system continues to excel with high coverage, equal rules and a reasonable level of pension benefits. Reforms have entailed both impairments and enhancements for the people, but so far, economic well-being among pensioners has not deteriorated. In future, the picture may alter. Further challenges in adequate pension provision include non-

[59] *Reipas and Sankala* (n 45)

[60] Finnish Centre for Pensions, '*Effects of pension reform emerging – workings lives extended as expected*', press release 30.10.2019 https://www.etk.fi/en/tiedote/effects-of-pension-reform-emerging-working-lives-extended-as-expected/ accessed 27 February 2020

[61] *Tikanmäki and others* (n 33)

standard work, especially (solo) self-employed[62] and gender differences in pensions[63]. The people trust the pension system and so far, pension policy has not been the object of destructive political struggle as in many other countries. The tripartite decision-making in the design of the reforms of the earnings-related pension scheme has been astonishingly goal-oriented and capable of adapting to major challenges.

Reforms will also continue in the 2020s. Currently, proposals to change the legislation regarding changes to survivors' pensions are being drafted and preparations to merge parts of the public and private sector pension systems are at hand. Social partners have also agreed to carry on negotiations, inter alia, on disability pensions, occupational rehabilitation and the financing mechanisms of pension provision. Decreasing fertility poses threats to funding as do slow economic growth and low interest rates. The financial sustainability remains a central challenge, but simultaneously questions of inter-generational justice and adequate pension are becoming increasingly important. In this vein, supplementary pensions may also gain greater role in the Finnish pension landscape in the years to come. As in many other countries, the story of the Finnish pension system is a never-ending story of reforms and adjustments.

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