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The Role of Pension Policy in Promoting Longer Working Careers of Older People

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ABSTRACT

Over the next decades European countries will experience a steep increase in the share of elderly persons and a considerable decline in the share of prime working-age population. Finland is one of the first countries which have to face the ageing problem. The post-war baby-boom cohorts are retiring already during the latter half of the current decade and the initial years of the next decade, that is, earlier than in many other European countries. The crucial question is how to activate population groups with characteristically low labour force participation.

The focus of the article is on the employment development of older people. In Finland, over the last ten years the employment growth of aged 55–64 has been record-breaking in the EU. The question is what background factors are behind the fast increase of employment rate of older persons and what is the role of pension policy measures in the exceptional growth.
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1 Introduction

Over the next few decades most European countries will experience a steep increase in the share of elderly persons and a considerable decline in the share of prime working-age population. Consequently, the number of workers leaving the labour market will increase rapidly and eventually exceed the number of new entrants to the labour market. Finland has recently proved this change: there are yearly more new retirees than young newcomers to the labour force. If the work and retirement patterns would remain unchanged, the economic burden will become heavy for working-age population.

There are good signs about the changing work and retirement patterns. Finland has witnessed the largest increase in the employment of older workers since the mid of 1990s among the EU countries. After the deep recession in the beginning of 1990s the latter half of the decade was a period of rapid economic growth, and an increase in the employment of older workers has been record-breaking in Finland. While the employment rate of aged 55–64 in Finland was 34 per cent in 1995 – nearly the same as the average rate in the EU15 countries – the current rate 55 per cent is over ten percentage points higher than the rate of the EU15.

The strong growth of employment among older people has reduced the proportion of older people outside the labour force. The decrease of the inactive population aged 55–64 has been much more marked in Finland than the average decrease in the EU15 countries (Employment in Europe 2007). The change is seen in the prevalence of early retirement in Finland: the proportion of retired persons among aged 55–64 has decreased from 56 percent to 37 percent during 1995–2006. Continuing at work until old-age pension is more common now than ten years ago.

The demographic development emphasizes the role of older workers in the labour market. Since the mid-1990s ageing workers have been on the agenda of numerous meetings in the EU. In the early years of 2000s the EU introduced strict employment targets for 2010, which include the aim to raise the average employment rate of older persons to 50 per cent by the end of the decade. Although, the target has been reached in Finland as well as in some other EU countries, in the EU level it means big challenges for most member states. The increasing employment is a crucial element for making the EU the most competitive economy in the world over the current decade according to the Lisbon strategy.

In Finland the post-war baby-boom cohorts are retiring already during the latter half of the current decade and the initial years of the next decade, that is, earlier than in many other European countries. The ageing problem is already at hand in Finland, which can lead up to a worsened competitive position of Finland due to decreasing labour supply. In Finland, the female employment rate is already comparatively high. Work oriented immigration cannot be expected to rise rapidly. Therefore, the attention is directed to the employment growth of older people. The interesting question is what the background factors behind the recent development are.
2  Factors behind the strong employment growth among older people

The exceptionally rapid rise of the employment rate of older persons in Finland since the mid
of 1990s is a consequence of the combined effect of the number of different factors. The fast
economic recovery after the severe recession in the early years of 1990s has contributed to
the employment growth. Although the economic growth in Finland has been among the high-
est in the EU, it doesn’t explain alone the exceptional development. While the employment
rate of the working-age population has increased about 6 percentage points since 1997, the
employment rate of aged 55–64 has increased by 21 percentage points (see Figure 1). The big
difference between these age groups indicates that the rapid economic recovery cannot be the
only explanatory factor behind the rising employment rate of older people.

Figure 1. Employment rate of the working-age population (15–64) and of aged 55–64 in
1997–2006, %.

Besides the favorable economic development, the change of pension policy with the aim to
hinder early retirement has played a crucial role. In order to understand the total turn, we have
to keep in mind the impact of the severe recession in the early years of 1990s, challengers
of ageing population, growing costs of retirement in the long term and the expected labour
shortage. All these contributed to the general view that the change in the pension policy is
needed. (Uusitalo 2007.)

Finland became reasonably early conscious of the need to reappraise the pursued policies
due to the rapid ageing of the population. The change from early retirement policy to the
policy promoting staying at work is dated at the turn of 1980s and 1990s. While the most of
eyearly retirement benefits were introduced in the 1980s – and they became popular exit routes
from the labour force – the first signs of change from the early exit policy to more restrictive
practices were seen at the end of the 1980s. Two parliamentary committees (1987 and 1990) suggested several reforms with aim to increase years in labour force and to control the foreseen growth of pension expenditure. Most of the suggested reforms have been implemented during the 1990s and the 2000s.

It is noteworthy that in Finland, the employment rate fell exceptionally deep during the recession in the early years of 1990s. After the recession the flood to unemployment reduced and the unemployment risk decreased. The baby-boomers avoided the hardest effects of the recession and the permanence of their employment has been much better than that of the older cohorts (Hytti and Nio 2004). The so-called “cohort effect” has contributed to the employment growth of aged 55–64 clearly. The baby boomers reached the age of 55 during the first years of the 2000s. The qualities of the baby boomers concerning education, health and “work orientation” are better than the qualities of older cohorts at the same age. These factors contributed to the better job permanence of the baby boomers.

Furthermore, the tight fiscal policy and employment policy promoting job creation as well as the comprehensive national action programs for improving working life have contributed to the growing employment of older persons. Also a rising level of training has promoted employment growth among older population (Ilmakunnas and Takala 2005; Tuominen 2005). Behind the rapid increase of employment of older people is also the fact, that it has been possible to find new solutions for coordinating the needs of the labour market and the social protection systems. An essential aspect behind the successful policy is the functioning tripartite cooperation which takes the needs of all the parties involved into account. The cooperation has made it possible to develop the legislation by reconciling the economic and social factors by paying attention to challenges caused by ageing population.

The turn in the pension policy – a crucial factor behind the trend

During the 1990s there was made several changes in pension legislation, which restricted the early retirement possibilities, weakened the index-linking of pensions and decreased the pension accrual from so-called projected pensionable service until the age of old-age retirement. Also the period for calculating the so called pensionable wage was extended from last four years to last ten years of each employment contract. The general right to get basic amount of the national pension was abolished: other pension income began to reduce the basic amount. The pension benefits in public sector with better terms were changed so that gradually they correspond to benefits in private sector.

During the 1990s and the 2000s there was made many increases in the lower age limits of early retirement schemes. Particularly increases in the lower age limits of the so-called unemployment pathway to retirement and of the individual early retirement pension have proved to be effective in restraining early exit from the labour market (Ilmakunnas and Takala 2005; Tuominen 2005; Ilmakunnas and Takala 2005; Tuominen 2005).

The public pension system in Finland is made up of two components, the statutory earnings-related pension scheme and the national pension. The aim of the earnings-related pension is to guarantee that the attained income level is maintained to a reasonable degree and the national pension guarantees a minimum income at the old age and in the event of disability and death of the breadwinner.
Kyyrää and Wilke 2004). It is to be noted that the increase in employment rate has been highest in the age groups which are most affected by the restrictive changes in the early exit systems. The increase in the age groups of 55–63 is over twice as high as the average increase in the working-age population (see Figures 1 and 2). Nevertheless, when the pension policy consists of many simultaneous measures, it is difficult to isolate the exact effect of a particular change from all policy measures.

**Figure 2. Employment rate by age in 1997 and 2006, %.

![Graph showing employment rate by age]


The pension reform 2005 is a cornerstone of pension policy promoting later retirement. The reform is the most profound change in the earnings-related pension scheme during its history. The reform aims in the long term to postpone the effective retirement age by two or three years, to adapt the pension scheme to an increasing average life expectancy, and to pave the way for unification and simplification of the earnings-related pension scheme in the private sector. The main contents of the reform 2005 are:

- The fixed retirement age of 65 was abolished and the flexible retirement age between ages of 63 and 68 was introduced.
- Minimum age for early old-age pension was raised from the age of 60 to the age of 62.
- The pension is calculated on the bases of the earnings from the entire working career. The calculation formula emphasises working years at a mature age: the pension will accrue at the rate of 1.5 per cent a year from the age of 18 up to the age of 52. After that the rate will increase to 1.9 per cent for the period of ten years (53–62). From the age of 63 the accrual rate is 4.5 per cent, which will work as an economic incentive to continue working instead of retirement.
- The individual early retirement pension and the unemployment pension have been abolished. The first mentioned was a disability pension for 60 year olds and over with less
strict medical criteria than the ordinary disability pension. The age limit for unemployment pension was also 60 years, but persons born in 1950 or later have not any more right to get the unemployment pension.

- The so-called life expectancy coefficient will be introduced in 2009 and it is designed to curb pension expenditure resulting from increased life expectancy. The coefficient will cut the pension if the life expectancy increases, but a person can compensate the cutting efficiently by working longer.
- The pension accrues also from the period of study and from the period of child home care allowance while a parent is taking care of a child under the age of three.

The impacts of the pension reforms will be seen gradually during the coming decades. According to the forecast of the Finnish Centre for Pensions the expected effective retirement age is predicted to increase from the current age of approximately 59 years by 2 years by 2025 and by 3 years by 2050 (Biström et al. 2005).

Also the impacts of the pension reform on the pension expenditure and the pension contribution are considerable. Without reforming the pension scheme the increase would have been clearly higher (Työryhmäraportti 2002; Report by the SOMERA Committee 2002). According to prognosis the changes made in the 1990s will lower the pension expenditure in relation to the GDP about by four percentage points until 2030 than it would have been if the legislation in force in 1990 would have remained unchanged. The reforms made in the 2000s will reduce the ratio of pension expenditure to the GDP by about one percentage point by year 2030. Still, the current level of 11 per cent from the GDP will rise to about 15 per cent by 2030 due to the ageing population. In the longer term the ratio of the pension expenditure to the GDP will decrease by two percentage points. The pension contribution for private sector employees increases from current 21 per cent by about 6 percentage points by 2030, after which the contribution level will remain more or less the same (Biström et al. 2005).

Although it is too early to form an exact picture of the impact of the pension reform 2005 on the employment growth during last two years, considering retirement development the start of the reform has been promising. The reform provides strong incentives to postpone retirement and to continue working after the age of 63.

**Policy outcome: at a brisk pace towards later retirement**

The change from the policy contributing early exit to the policy promoting later retirement has got results. There is seen a clear downward trend both in prevalence and incidence figures of early retirement (see Figures 3 and 4). While the proportion of employed persons among the aged of 55–64 has increased considerably, consequently the proportion of early retirees has decreased over last ten years. A considerably smaller proportion of people are now on early retirement pension than in the beginning of the 1990s. Including part-time pensioners, the share of retired persons in the age group of 55–64 years fell from 58 per cent in the beginning of the 1990s to 42 per cent in 2006 (see Figure 3). The most important single factor contribut-
ing to the falling share is the reduction in individual early retirement pensions. In the pension reform 2005 this pension benefit was abolished.

Incidence of new pensions indicates a downward trend in the earnings-related pension scheme over the last ten years (see Figure 4). There is seen a strong decreasing trend in unemployment pensions in the 2000s. During recent years also the incidence of disability pensions has turned downward trend. Only exception from the trend is the incidence of old-age pension in 2005. The reason for this was that in the first year of the reform three age groups became entitled to earlier retirement (those born in 1940–1942). Already in 2006 the incidence of old-age pension turned downward, and in the coming years it is expected to decrease due to financial incentives for those who continue working after the age of 63 and due to the increased lower age limit of early old-age pension.

The effects of the changed pension policy are seen in average retirement age: during last ten years the expected effective retirement age of the 25 year-old person has increased by 0.7 years and the expected retirement age of the 50 year-old person by 0.9 years (Kannisto 2006). The latter indicator is more sensitive to the changes in the early retirement legislation. In Finland, the development of the average retirement age is followed by the expectancy calculated for those aged 25 and 50 years. The new indicator meets the targets set for a good indicator. It reacts to the retirement risk immediately and in the right direction, and it is independent of the age structure of the population.

**Figure 3.** The proportion of pensioners aged 55–64 in the population of comparable age over the years 1990–2006, %.

*) Old-age and early old-age pension, special pensions for farmers and front veterans' pensions.
Source: Finnish Centre for Pensions.
Figure 4. The age standardized incidence of statutory earnings-related pensions (in private and public sector excluded part-time pensions) among people aged 55–64 in 1996–2006.


Source: Finnish Centre for Pensions.

In the Finnish Centre for Pensions it was forecasted that from the amendment of pension reform 2005 the effective retirement age would rise by 0.7 years until the end of the 2000s. The expected retirement age has risen by 0.4 years since the reform. Within two years the average retirement age has increased more than half from the calculated increase for the latter half of the current decade. The start of the pension reform exceeded expectations.

The national strategy for active ageing

The shift of the policy promoting early exit to the policy encouraging later retirement was not only limited to changes in early retirement schemes. Finland has also responded to the challenge of ageing population with large-scale national action programs concerning many aspects of working life.

The Age Committee in the early years of 1990s provided the starting point for the development work. The guiding principle of the committee was to influence attitudes. The National Programme on Ageing Workers (FINPAW) based on the committee’s proposal. National programs were started even before the European Employment Strategy existed. The Government launched the FINPAW in 1998 with aim of improving ageing employees’ ability to continue at work productively with good work ability. The program was implemented in 1998–2002 and it consisted of comprehensive information and training projects. (The National Programme for Ageing Workers 2002). The target group of the programme was the whole population, decision-makers, employers and employees, occupational health care etc. From international point of view, a holistic approach to the active ageing policy has been a characteristic feature in Finland.
The program included a variety of measures related to employees’ health, their coping at work and improvement of their skills. It also included extensive research and projects for development of working life. Both national and international evaluations of the program showed clear positive effect on favourable attitudes towards older employees. Although it has been difficult to specify the program’s independent effects on the employment growth of ageing workers, undoubtedly it has intensified the favourable trend among older people.

In 2006, Finnish policies to facilitate the social inclusion of aging workers got international recognition when The Bertelsmann Foundation awarded Carl Bertelsmann Prize to the FINPAW. According to the arguments of the prize, particularly commendable in the case of Finland is the consistent national-level strategy and commitment to implementation of the action program on the part of the government, several ministries, social partners and many non-governmental organizations.

After the FINPAW several simultaneous action programs have been launched to promote the attractiveness of working life, to raise the educational level of poorly educated older workers, to establish good practices for older people at the workplaces and lengthen the working career. For example, the new programme for promoting attractiveness of work and working life, the so called VETO (“attraction” or “pull”), has been set for the period 2003–2007. The program covers five areas: the quality of working life and safety at work, effective occupational health care and rehabilitation, diversity and equality in working life, income security and working incentives and rising awareness.

Besides above mentioned programs there have been several work-promoting programs during the last and current decade, which have contributed to the favourable outcome in employment of older people. For instance, in the field of education the so-called NOSTE (“lift”) program was implemented in the period 2003–2007. The main aim of the program is to improve the competence of prime-age workers between ages of 30 and 54.

National programs promoting active ageing have been launched by the Government and administered and implemented by several ministries, social partners and non-governmental organizations.

From the point of view of age policies, Finland as most European countries has failed in the efforts to integrate ageing unemployed people into work life. There are still a big proportion of older unemployed persons (see Figure 5). About 9 per cent of aged 55–64 was unemployed jobseekers and 7 per cent was retired on unemployment pension in 2006. Mostly the unemployment of older people ends to the retirement and seldom to the re-employment. Nevertheless, the inflow to the unemployment has decreased. In the long term, on condition that the favorable economic growth continues, unemployment among older people could decrease. For the time being, the persistent unemployment problem restricts the employment growth among older persons.
**Figure 5.** The employment rate, the proportion of unemployed jobseekers at the employment service and the proportion of pension recipients *) of 55–64-year-olds 1994–2004.

*) Part-time pension excluded. Part-time pensioners belong to the employed population.
Source: Statistics Finland, Ministry of Labour and Finnish Centre for Pensions.
3 What can be said about the future development?

Finland has been successful in raising the employment of older people, but there is more to be done. Still, the employment rate of aged 55–64 is much lower and correspondingly the proportion of retired population higher in Finland than in other Nordic Countries (see Figures 6 and 7). The difference between Finland and neighbouring countries is wide in the age group of 60 years and over. Expectations for increasing employment are directed to this age group. This is justifiable due to the fact that people over 60 are the primary target group of the pension reform 2005: two important retirement pathways for 60 years and older have been abolished (the unemployment pension and the individual early retirement pension), the minimum age for early old-age pension is increased by two years and the better pension accrual rate from age of 63 is planned to attract people to continue working between ages of 63 and 68. The use of early retirement will be decreasing also due to the fact that in the future those who retire from the public sector will be covered by the same retirement ages and rules which are applied in the private sector.

The results of the survey concerning older employees show that about the fourth of Finnish employees are willing to postpone retirement beyond the pensionable age in the future, but are not ready to delay it very far. The willingness for early retirement is still prevailing intention among older workers. Working life conditions are closely connected with plans to continue at work. In order to achieve the goal extending the working career and postponing the retirement it will be important to pay particular attention to the demands set by work for older employees. Also, the attitudes of the working community towards older people affect workers’ decisions on retirement. There is a clearly stronger willingness to continue working in establishments where the employees are supported in their plans (Forma et al. 2005). The attraction of the working life for older people is the key to longer working careers.

Figure 6. The employment rate of older people (55–64) in Finland, Sweden, Denmark and the EU in 1997–2006.

The results of the survey of employers made it possible to evaluate that continuing at work is supported at least to some extent in almost two establishments out of three, but the strong support is rare. However, it was promising to find out that the attitudes of employers towards new flexible retirement ages and older employees’ possibilities to continue at work were rather positive (Tuominen et al. 2005). The need for labour force clearly increases the willingness of the establishments to care for their oldest employees and also hire older people to a larger extent than at present. The economic situation of the firm clearly affects the employers’ assessments of support for continued work. (Tuominen and Takala 2006.) A economic growth is thus ultimately the key to improved employment among older people.

Studies based on a dynamic macroeconomic model (Lassila and Valkonen 2007) and on a stochastic life cycle model (Hakola and Määttänen 2007) suggest that in the long run the pension reform 2005 will increase the labour supply and raise the effective retirement age. The significance of the effect varies between studies, but the trend is the same.

In brief, it is too early to have an exact picture of the impacts of the 2005 reform. The effects could be marked only in the long term. However, surveys and economic studies as well as long term prognoses indicate that the reform promotes active ageing, extends the working career and postpones the effective retirement age.

In the future, also other measures such as national programs for promoting active ageing are needed for supporting the employment growth among older people. The Ministry of Social Affairs and Health promotes government policy in its own sector of administration in the way which supports active ageing. It concentrates four strategic policies: promoting health and functional capacity, making work more attractive, reducing poverty and social exclusion and providing efficient services and reasonable income security (Strategies for Social Protection 2015). The fundamental idea is to improve people’s health and functional capacity and to make work more attractive for getting more people to participate in working life.
4 In conclusion

The exceptionally fast rise of the employment rate of older persons in Finland since the mid of 1990s is a consequence of the combined effect of the number of different factors. The employment growth can mainly be explained on the one hand by the strong growth of the economy and on the other hand by the changes of pension legislation. Changes of early retirement schemes have clearly had impact on the described trend: the increase in employment rate has been highest in the age groups which are most affected by the restrictive changes in the early exit systems. At the same time the measures of active ageing policy have contributed to the more favourable attitudinal climate towards older employees in the labour market. Evaluations of the extensive national action programs show positive effects on the labour market situation of older persons.

The factors behind early vs. late retirement are complex and involve several economic and non-economic matters. While the public debate often focuses on the economic incentives of retirement, there are undoubtedly many qualitative matters, things related to working life which affect the attitudes and perceptions of both employers and older employees’ retirement views. There is still room for improvement in the situation where according to studies only in a small proportion of the workplaces older employees have got strong support for continuing at work longer. In addition, the weak re-employment of unemployed older persons is still a tough problem in Finland.

The new pension system is a trimmed version from the old one, which gives Finland an advantage in further increasing the employment among older people. In the near future the baby-boomers in Finland will make their retirement decisions. These post-war cohorts have stayed at work better than older cohorts at the same age, and it is expected that they are likely to stay on the labour market longer than the preceding cohorts. The demographic development, the decreasing trend of working-age population will strengthen the labour market situation of older people. Eventually, the favourable economic development and good demand for labour is essential for increasing employment.
Sources


The Finnish Centre for Pensions is the statutory central body of the Finnish earnings-related pension scheme. Its research activities mainly cover the fields of social security and pension schemes. The studies aim to paint a comprehensive picture of the sociopolitical, sociological and financial aspects involved.

Working Papers is an English-language publication series. It contains, for example, papers presented by Finnish pension experts at international conferences. It is also a forum for the results of small-scale studies that are likely to be of interest to an international audience.