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Economic Welfare of Pensioners and the Income Distribution

The study compares the level, composition and distribution of pensioners' income to that of other socioeconomic groups in the period 1990–2004. The most important groups of comparison are wage earners, self-employed persons and the group of persons outside the labour force, i.e. long-term unemployed and students. In addition, we examine how changes in pensions and economic welfare of pensioners have affected the evolution of income distribution and poverty. Being pensioner is determined on the basis of the individual person's socioeconomic status, but economic welfare of the pensioner is assessed on the basis of the household that he or she belongs to. When calculating economic welfare the household's total disposable income is divided by the Modified-OECD scale. The study utilizes Finnish Income Distribution Survey data based on a population sample.

In 2004 the disposable income of a middle-income pensioner per consumption unit was 16,600 euros per year. This is approximately 70 per cent of the income of a middle-income wage earner. In real terms the income has increased by one-fourth from 1990. Compared to middle-income wage earners pensioners lag behind, however, since after the economic crisis in the early 1990s the incomes of wage earners have increased faster than those of pensioners. On the other hand, during the crisis the economic welfare of pensioners in relation to wage earners was higher than normally.

The pension is the most important source of income for the pensioner, but other types of income also matter. For instance, the income of middle-income pensioners aged 55–64 was supplemented by the spouse's labour income. Then, as regards the pension recipients younger than 55 the share of other transfers than pensions was relatively high. Among pensioners

who have reached the age of 75, the imputed rent of owner-occupied housing (included in capital income) was important. The income structure of pensioners showed clearly how an increasingly larger proportion of the income consists of the earnings-related pension. The maturation of the earnings-related pension scheme has been the most important reason for the real-term increase in average pensioner income over the observation period.

The developments in income inequality and poverty are investigated by decomposition analysis. In this way the measures for inequality and poverty are broken down into components, which for example account for the effects of the poverty risk of different population groups on the poverty risk of the whole population. Correspondingly, the Gini-coefficient (our measure of income inequality) can be divided into components which describe the effects of both pensioners' disposable income and their income structure on the population value of the Gini-coefficient.

Significant changes occurred in the income distribution in the 1990s. The Finnish economic crisis in the early 1990s was characterised by mass unemployment and a rapid fall in income levels. As a consequence, especially wage incomes were distributed more unequally than before. At the same time the income inequality in disposable incomes decreased. The reason for this was income transfers. During the economic crisis the relatively favourable development of pensions can be distinguished.

As rapid economic growth set in the latter half of the 1990s, the income inequality started to increase and the income distribution changed as much in a couple of years as in the two previous decades. Decomposition analysis showed that the effect of labour income on increase in income inequality was fairly small. On the other hand, increases in capital income had a strong effect on the Gini-coefficient, and the redistributive effect of taxation has correspondingly diminished. In addition, quite modest rise in income transfers, especially as regards minimum income, has increased the income inequality. The role of pensioners' disposable income and pensions has been fairly small, when considered in relation to the effect of the growth in capital incomes, taxation and for instance the income development of self-employed persons.

When comparing income differences within the groups, the income inequality among the self-employed persons is the largest. Currently, the income inequality among wage earners and pensioners are of the same magnitude. The analysis showed that the growth in income inequality after the economic crisis was affected by developments for both persons with the lowest incomes and persons in the highest income brackets, as the developments differed from that of middle-income earners.

All in all the change in the income distribution of pensioners changed was similar to that of the whole population and of wage earners. For instance, the growth in capital incomes, which increased income inequality, is also present in the top income decile of pensioners. Only modest increase has occurred in the incomes of the bottom income decile of those outside

the labour force, that is, long-term unemployed and students. In this group the importance of labour income has decreased compared to the situation in the early 1990s, and their income is currently based mainly on income transfers.

During the economic crisis in the 1990s the relative status of pensioners improved, since the pension levels were linked to the earlier before the crisis level. As a consequence of this their risk of poverty fell to less than one-third of the level in 1990 using a poverty line of 60 per cent of median income. If a lower, 50 per cent poverty line is used the change is not nearly as dramatic. The explanation for sensitivity of the poverty risk measurement to the choice of poverty line is that in 1990 the income distribution of pensioners was highly concentrated near the 60 per cent poverty line, whereby minor changes in median income and the poverty line dramatically changed the number of poor people.

After the economic crisis the relative poverty levels started a steady increase, so that in 2004 the poverty risk of the whole population was 1.5 times that of 1990. Although pensions and other transfers lagged behind the general income development, after the crisis the poverty risk of pensioners increased only slightly faster than that of the whole population, being 13 per cent in 2004. Of the groups compared, poverty is nowadays most frequent in the group of people outside the labour force, who live on social security benefits. This group consists of students and long-term unemployed. The increase in the poverty risk of unemployed persons is the most important factor explaining the increase in poverty in Finland.

The economic development of the 1990s are shown most clearly in the evolution of the poverty risk. The mean poverty gap of the poor has remained remarkably stable over the whole observation period. In Finland poverty has rather become more frequent than deepened. Even though the incomes fall below the poverty line, the poverty gap and at the inequality among the poor remain relatively small. Also the differences in mean poverty gap between the groups are small compared to those in the poverty risk. In terms of poverty gap the income problems of pensioners are less severe than on the average, and it also seems that pensioner poverty has not deepened from that of 1990.

The analysis by age groups showed that the poverty risk of old-age pensioners increases with age. However, the poverty risk of younger pension recipients aged less than 55 is also higher than average.

In all age groups the poverty risk of single persons is clearly higher than for others. At the same time the differences between different income recipients and age groups are accentuated. The group which nowadays has an especially high risk of poverty is the group of long-term unemployed aged 55–64. Since they are near retirement age, in the future this will be of significance for the poverty risk and the depth of poverty of pensioners.

Gender is also significant. The poverty risk of single men under the age of 65 who have retired or are long-term unemployed is generally higher than for the corresponding groups of women.

On the other hand, the poverty risk of nearly 30 per cent in 2004 for single women aged over 74 was clearly higher than for men of corresponding age. The pension indexation may in future cause problems as regards the income of elderly people and of persons who have been retired for a long time.

The economic of welfare poor pensioners mainly relied on the person's own incomes. The share of earnings-related pensions in the income has increased continually, but in 2004 the mean share of earnings-related pensions still stayed below the level of other pensions for persons aged over 74 and for those younger than 55. Correspondingly, other income transfers than pensions played a minor role on the income of poor pensioners. Here the larger share of housing income than for other corresponding groups can also be distinguished.

The income of poor persons outside the labour force consists almost solely of other income transfers than pensions. The feeble development in social security shows through in their income, which has remained more or less unchanged in real terms over the whole observation period. It does not show a similar increase as for poor pensioners.

In international comparison studies income and poverty line are defined solely on the basis of cash income. Pensioners more frequently than on average live in owner-occupied housing. Without housing income the poverty risk of pensioners is 3.5 percentage points higher than if housing income is included. For women aged over 75 the difference is even larger, and their poverty risk rises by almost 9 percentage points when assessed in this way.

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