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EXECUTIVE SUMMARY

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Projections on the effects of the 2017 earnings-related pension reform

– Assessments based on the Government bill

In this report, we present projections of the effects of the government bill on the 2017 pension reform. Our projections are based on the long-term projection (LTP) model of the Finnish Centre for Pensions.

According to the government bill, the general retirement age will rise to 65 years by 2027, after which it will be determined based on the development of life expectancy. The retirement age is estimated to rise to 65 years and 9 months for persons born in 1970 and 67 years and 7 months for those born in 1990.

The government bill is estimated to postpone retirement by 1.3 years by the year 2040 and by nearly two years by 2080, when using the expected effective retirement rate as an indicator. In the long term, this will reduce the number of retirees, which will be manifested in the rising number of both employed and unemployed persons.

According to our estimates, the annual earnings-related pension expenditure relative to the insured earnings will decrease as a result of the bill. The impact on the pension expenditure ratio will be at its highest, approximately two percentage points, in the 2030s and the 2040s, due to both the reduction in pension expenditure and the increase in earnings. In the long run, the government bill will increase both earnings and the pension expenditure and, according to the projection based on the bill, the pension expenditure ratio will return to the level of the projection under current legislation.

The public-sector pension expenditure ratio will be reduced more than that under the Employees Pensions Act since the pension expenditure relative to the earnings is higher in the public sector. The effect on the pension expenditure ratio under the Self-employed Persons' Pensions Act and the Farmers' Pensions Act is larger and more long-term than on the pension expenditure ratio under the other pension acts. This is due to the fact that the other earnings-related pension acts are proposed to be amended so that the wage-earner's share of the earnings-related pension contribution would no longer be reduced from the pensionable earnings. Even at present, this reduction is not made in insurance under the Self-employed Persons' Pensions Act and the Farmers' Pensions Act.

The reduction in the pension expenditure under the Employees Pensions Act allows for a lower contribution level in the projection based on the reform than in the projection based on current legislation. According to the projection based on the government bill, the contribution under the Employees Pensions Act can be kept at 24.4 per cent until the end of the 2060s. Alternatively, the contribution can be reduced as of the latter half of the 2020s. In that case, the amount of the assets under the Employees Pensions Act relative to the insured wage sum will remain at a lower level, which means that, in the long term, as the pension expenditure grows, the contribution will have to be increased at a faster pace.

As a result of, on the one hand, the amended rules concerning how the pension is determined and, on the other, of the extended working lives, the average pensions are projected to rise. The mitigation of the life expectancy coefficient, in particular, will raise the pensions of persons born in 1965 or later. As a result of the reform, the average pensions of those born in 1960 will grow by approximately two per cent, while the impact on those born in 1980 will be nearly ten per cent.

Due to the reduced time spent in retirement, however, the government bill will reduce, on average, the life-cycle pension income under the Employees Pensions Act for persons born in the 1960s, the 1970s and the 1980s. The effect will be approximately three per cent at its highest for those born between 1970 and 1975. The effect of the government bill on life-cycle contributions under the Employees Pensions Act strongly depends on how the contribution under the Employees Pensions Act will develop in the future. If the contribution under the Employees Pensions Act is kept at 24.4 per cent until the 2060s, the capital value of the contributions paid under the Employees Pensions Act of those born between the 1960s and the 2000s will increase due to the pension reform. If the contribution is reduced medium term, the capital value of the contributions paid under the Employees Pensions Act of those born in 1975 and later will decrease due to the pension reform.

The effect of the government bill on the capital value of already accrued pensions will be minor as different factors will affect in different directions. The raising of the retirement age will reduce the value of pensions accrued since the raising of the retirement age will not be taken into account from the beginning when determining the life expectancy coefficient. On the other hand, the value of the accrued pensions will be increased by, for example, the increment

for deferred retirement calculated on the pension after reaching the earliest eligibility age for retirement and the new early retirement forms. At year-end 2014, the amount of accrued pensions in the projection under the current legislation, when using an interest rate of 3.5 per cent, is EUR 604.8 billion, while it is EUR 606.8 billion in the projection based on the reform.

The economic outlook will also in the future significantly affect the financing of earnings-related pensions. If the financial basis of earnings-related pensions becomes narrower due to, for example, a slower growth of the earnings level or weaker employment rates, the premium income that accrues via pension contributions will be reduced, unless the pension contributions are raised. The received return on the pension assets will also significantly affect the size of the pension contribution required to cover the pension expenditure. We have projected the impact of the future economic outlook through two sensitivity calculations. In one of them, the economic development is permanently slower than in the baseline projection, and in the other sensitivity calculation, a weak economic outlook temporarily slows down the economic growth. Based on sensitivity analyses, the contribution level under the Employees Pensions Act that is required to finance pensions may have to be raised by several percentage points due to a weaker economic development.

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