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

In the agreement of the 2017 pension reform, the earliest eligibility age for old-age pension will rise gradually by three months per year until 2027, starting from the 1955 birth cohort. As of the 1965 birth cohort, the earliest eligibility age for old-age pension will be linked to life expectancy. The earliest eligibility age for old-age pension will rise so that the ratio between the expected working life (time from age 18 to the earliest eligibility age for old-age retirement) and the life expectancy at the eligibility age will remain stable. For example, for people born in 1970, the projected earliest eligibility age is 65 years and 11 months, and for those born in 1995, 68 years and 1 month.

As a result of the reform, earnings-related pension will accrue as of age 17 at an annual accrual rate of 1.5 per cent and without the employee’s earnings-related pension contribution reducing the pensionable earnings. For persons aged 53–62 years, however, pension will accrue at a rate of 1.7 per cent until the end of the year 2025. If the pension is deferred past the earliest eligibility age for old-age pension, the pension will be increased with an increment for deferred retirement of 0.4 per cent per each deferred month.

The life expectancy coefficient will be calculated in a different way when the retirement age will be linked to life expectancy. The life expectancy coefficient will cut the benefit level less than it would under currently valid legislation. A target retirement age will be calculated for each age cohort. It indicates to which age persons of a specific age cohort should defer retirement in order to compensate the effect of the life expectancy coefficient with the increment for deferred retirement.
As the earliest eligibility age for old-age pension will rise, the termination age of the projected pensionable service of the disability pension will also rise. The accrual rate for the projected pensionable service will remain at 1.5 per cent. The life expectancy coefficient will be applied to the entire disability pension when the way in which it is calculated will change as described above.

The new reform will introduce a new pension type: the years-of-service pension. This pension may be granted to an applicant who has turned 63 years and whose working life, spanning at least 38 years, has mainly involved strenuous work. This age limit will rise in line with life expectancy in the same way as the old-age retirement age will rise as of age 65.

As of 2017, the part-time pension will be replaced by a partial early old-age pension. The latter deviates from the current part-time pension in two essential ways. Firstly, there will be no limitations to the amount of work that can be done while drawing a partial pension. Secondly, the benefit will be reduced by an actuarial reduction for early retirement (0.4% per month) if the benefit is drawn before the earliest eligibility age for old-age pension.

In 2017–2019, the average contribution under the Employees Pensions Act will be 24.4 per cent. The goal in subsequent years is to achieve a steady and appropriate contribution development and to secure benefits also in the long run.

Pensions accrued by persons between the ages of 18 and 68 who are not currently receiving an old-age pension will be partly funded to an amount equalling 0.4 per cent of the accrual under the Employees Pensions Act. The old-age liabilities will be supplemented to meet the realised mortality rates. In addition, the funding rate of old-age pensions will be increased in 2017 and 2018.

The funds reserved for buffering insurance and investment risks will be combined in the future as part of the solvency reform. The larger weighting of shares in the pension system under the Employees Pensions Act will become possible by increasing the proportion of so-called equity-linked buffer funds.

In this report, we have assessed the effects of the proposed amendments to the benefits and financing of the earnings-related pension system by applying the long-term projection model (LTP) and the ELSI microsimulation model and example calculations. According to the presented calculations, the reform will defer retirement and increase the employment rate of the elderly. In 2013, the expected effective retirement age was 60.9 years. According to the consequence analysis, the expected effective retirement age will be 62.4 years in 2027, exceeding the projection made under current legislation by 0.8 years. The expected effective retirement age is projected at 64.4 years in the mid-2060s, which is 2 years more than in the projection under current legislation. As a result of the reform agreement, the number of employed persons is expected to rise by the year 2025 by approximately 24,000 persons, that is, by 1 per cent. The effect on employment in the 2060s will be 70,000–80,000 persons, which means an increase of 3 per cent to the number of employed persons.
As the employment rate grows, the economy’s wage sum will rise, and as a result of the deferred retirement, the pension expenditure will be reduced. This means that the pension expenditure relative to the economy’s wage sum will also be reduced. In 2025, the effect on the ratio of the earnings-related pension expenditure to the wage sum of the entire economy will be slightly below 1 percentage point. At most, in the early 2040s, the effect will be an ample 2 percentage points.

The reform will increase the monthly level of pensions. At first, the effect will be slight, but in the long run, it will be accentuated. Compared to the current situation, the purchasing power of pensions will grow, although the pension level relative to the average earnings level will decrease both under current legislation and according to the consequence analysis of the reform. Currently, the average pension is about half of the average earnings. According to the consequence analysis, the average pension would be approximately 44 per cent in relation to the average earnings as of the 2050s, slightly higher than according to the projections under current legislation.

Due to the rise in the benefit level, the reform will, in the long run, increase the earnings-related pension expenditure slightly, for example, by approximately 2.5 per cent in 2080. Yet, the wage sum will grow by nearly 4 per cent in the same year, in which case the reform will reduce the ratio between the pension expenditure and the wage sum also long-term. According to our projection, the reduction will be almost half a percentage point in 2080.

Under current legislation, the contribution under the Employees Pensions Act would be approximately 25–26 per cent in 2020–2080. As a result of the reform, the contribution level can be stabilised at the level agreed on in 2017, i.e. at 24.4 per cent, until the latter half of the 2060s. The contribution levels under the Self-employed Persons’ Pensions Act and the Farmers’ Pensions Act are linked to the contribution under the Employees Pensions Act. Consequently, as a result of the reform, the contributions under the former two acts will also be reduced. In addition, the share of expenses financed by the State under the Self-employed Persons’ Pensions Act and the Farmers’ Pensions Act will decrease.

The reform will affect the generations in different ways. Those who have already retired will be affected only indirectly, for example through an improvement of the public economy. The raising of the age limits will decrease the amount of time spent in retirement and, hence, reduce the value of pension liabilities. On the other hand, the rise of the monthly pension will have an opposite effect. Combined, the capital value of the pension income of those born in the 1960s and the 1970s is projected to decrease by approximately 3 per cent. The pension capital of men born at the beginning of the 1970s will be cut the most, by around 4 per cent. The value of the pension capital of people born in the 1990s or later will rise as a result of the reform. For them, the growth of the monthly pension will increase their pension capital more than the reduction of time spent in retirement will reduce them. The pension reform will also affect how much each generation will pay in pension contributions during working life. Due to the extension of working lives, the amount of pension contributions paid by the generations
born at the end of the 1950s and early 1960s will rise slightly. For later generations, the amount of the pension contributions paid during a life span will decrease as a result of the reduced contribution level. Hence, the youngest generations who are now in working life will benefit from the reform both in the form of growing benefits and decreasing contributions.

In this report, we have reviewed the consequences of a few sections of the agreement more closely. As of 2030, the mitigated life expectancy coefficient will raise the long-term expenditure, contribution and benefit levels. Even in the 2040s, the amendments to the way in which the life expectancy coefficient is calculated will have only a minor impact on pensions. In 2080, however, the mitigated life expectancy coefficient will raise the pension expenditure and the average benefit level by approximately 7 per cent. Relative to the wage sum, this amounts to an ample two percentage points. The increased accrual rate (1.7 per cent from 2017 to 2025 for those aged 53–62 years) during the transition period will raise the expenditure under the Employees Pensions Act relative to the wage sum from the 2020s to the 2040s by approximately 0.1–0.2 percentage points. Without the increased accrual rates of the transition period, the pension reform would make an exceptionally deep cut in the pension capital of those born in the early 1960s. As a result of the reform, the employee’s pension contribution will no longer be deducted from the pensionable wage. This amendment will raise the pension expenditure slowly but, in the long run, significantly. In 2025, the effect on the expenditure under the Employees Pensions Act will be approximately 0.25 per cent, that is, less than 0.1 percentage points relative to the wage sum. In 2080, however, the effect on the expenditure under the Employees Pensions Act will be as much as 5 per cent, that is, approximately 1.3 percentage points relative to the wage sum under the Employees Pensions Act.

The future development of the mortality rate will be reflected on the life expectancy coefficient and, as of 2030, also on the age limits of the pension system. The development of the mortality rate will have an effect on employment, benefit levels and contribution levels. Compared to current legislation, the effect of the mortality rate will not be as forceful on the benefit level but will be directed also at the employment rate and the contribution level. Starting disability pensions will mainly affect pension expenditures and contributions, but not the average benefit level in any significant way. Compared to current legislation, the effect of starting disability pensions on the expenditure and contribution levels will be emphasised due to the reform. Starting partial early old-age pensions or years-of-service pensions hold no greater overall significance unless their popularity becomes manifold relative to the level assessed in this report. The general economic outlook, on the other hand, is a key factor affecting the cost burden. If the employment rate was 3 per cent less than projected (i.e. if the projected effect of the reform on employment was not realised), and if the real growth of the earnings level was to remain at 1 per cent per year and the real investment returns of pension assets at 3 per cent, the contribution under the Employees Pensions Act should be raised to approximately 26–27 per cent. This would equal a level that is an ample 2 percentage points higher than that in the baseline projection.
We assessed the reform also from the points of view of various socio-economic groups and how the reform will affect the distribution of pensions. Working lives will be extended in all groups under review, but slightly more so for those with a high-level than those with a low-level education. Although working lives will be extended as a result of the agreement, the time spent in retirement will also be extended from the current level due to the extended life expectancy.

Compared to current legislation, it would seem that the reform will slightly reduce the time spent in retirement. Those born in the 1960s and later will spend a shorter time in retirement according to the agreement than they would do under current legislation. Those born in the 1970s and later will spend an ample one year less in retirement if the reform is realised. In particular, the reform will reduce the time spent in retirement of the highly educated and the younger generations. Relative to the time spent in retirement, however, the differences are minor.

The monthly pension of all groups under review will grow as a result of the agreement compared to the current projection. There are no major gender gaps when reviewing the changes in pension levels. In the long run, the reform will raise the pension level of the less educated slightly more than that of the more highly educated. The younger the age cohort, the more the monthly pension of the earnings-related pension system will rise. All-in-all, the agreement will slightly even out differences in pension levels in the long term, particularly those between the various age cohorts.

The calculations offer additional insight into the reform’s effects on the benefits. In general, the pension level of a person retiring at the earliest eligibility age for the old-age pension directly from the labour market will rise as a result of the reform. Nevertheless, if we compare similar working lives, the current legislation would generally give a person retiring from the labour market directly on an old-age pension a higher pension than the regulations under the reform would do. In general, the reform will increase the level of disability pensions.
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