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Pensions are no solution to the unemployment problem

Analysis of the suggested introduction of lower retirement ages as a measure against unemployment

THE CENTRAL PENSION SECURITY INSTITUTE

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Summary

In the early 1990s, economic growth came to a standstill in Finland. Unemployment figures surged and the rate of unemployment climbed to18%. In response to these developments, government set up various committees to explore the options available for reversing this unfavourable trend.

Several proposals for lowering pension ages temporarily have been made with the purpose of reducing the high rate of unemployment witnessed in the 1990s. These proposals have been publicly debated but so far they have not been carried out.

The low average effective retirement age combined with the high rate of unemployment is and has been one of the major problems of Finnish social politics of the 1990s: as many as nine in ten persons start to draw a pension before the general retirement age. In 1994, the unemployment rate was 18%, and still today it is 13-14%. This being the case, all the options available for lowering the unemployment rate are being explored. The aim of the suggestions, i.e. to find employment for young people, is well worth supporting.

The pensions suggested may seem cost neutral, and they are socially acceptable, in that they give elderly people a chance to retire and young people an opportunity to work. Calculations, however, show that the materialisation of these suggestions cannot be supported in financial terms. Indeed, the unemployment rate would seem to decline, but no new jobs would be created. At best, the suggestions would result in a change of people in already existing jobs.

The pensions proposed are incompatible with the trends in both pension and unemployment policy. The aim of social policy is to give people an incentive to continue working and to encourage retirees and unemployed people to return to gainful employment. However, introduction of the pension benefit suggested would cause the actual general retirement age to fall. Furthermore, the new pension benefit would conflict with other pension benefits.

Pension benefits were cut in 1996 in order to bring pension contributions and pension expenditure into balance both in the short term and in the long term. The aim of pension policy is to maintain this balance. However, quite opposite to these aims, the better the proposed pension would serve in terms of creating more employment opportunities, the more the pension contribution would increase and disturb the balance recently reached.

Provision of earnings-related pensions is based on joint responsibility between generations. The credibility and sustainability of the scheme requires that agreements and decisions are not changed to achieve short-sighted targets that are in contradiction with the aims of the pension policy pursued. Admittedly, unemployment continues to be a pressing problem in Finland, but it should be dealt with by means other than pension policy.

1. Introduction and background

In the early 1990s, economic growth came to a standstill in Finland and the economy of this country witnessed a serious depression, with severe repercussion for business life. Companies went bankrupt and people were made redundant. Unemployment figures surged and the rate of unemployment climbed to 18%. In response to these developments, government set up various committees to explore the options available for reversing this unfavourable trend.

Several proposals for lowering pension ages temporarily have been made with the purpose of reducing the high rate of unemployment witnessed in the 1990s. Some of the proposals include an obligation for the employer to provide employment to an unemployed job-seeker for every employed person taking retirement at a temporarily lower pension age, whereas other proposals include no such obligation.

The low average effective retirement age combined with the high rate of unemployment is and has been one of the major problems of Finnish social politics of the 1990s: as many as nine in ten persons start to draw a pension before the general retirement age. In 1993 and 1994, the unemployment rate was almost 18%, and still today it is 13-14%. This being the case, all the options available for lowering the unemployment rate are being explored. The aim of the suggestions, i.e. to find employment for young people, is well worth supporting.

Although all the laws concerning social security are passed by parliament, Finnish pension policy is closely integrated with the incomes policy system. The labour market organisations have played a key role in all the important decisions on the statutory earnings-related pension scheme. As a consequence, the Finnish pension scheme also has a long history of taking part in running the unemployment security plan, especially when it comes to providing for the elderly unemployed. A short introduction to the Finnish statutory earnings-related pension scheme follows in Appendix 1.

The statutory earnings-related pension scheme was introduced in the early 1960s, but in respect of pension financing the scheme will not attain maturity until the 2030s, which implies that the rate of the pension contribution is expected to increase until the 2030s. The financing of the scheme is partly based on funding. On the one hand, the rate of contribution for each year is calculated employing actuarial bases, but, on the other hand, the average yearly cost is negotiated by the labour market organisations. The aim of the negotiations is to adjust the cost to an admissible level not below the actuarial minimum level. The rate of contribution is confirmed by the Ministry of Social Affairs and Health. If the level is set below the actuarial minimum, a legislative amendment is always required. Because the contribution is fixed separately for each year, it is also possible, using the existing system, to negotiate new or temporary arrangements in the pension scheme to solve pressing, often short-term, problems in the field of social security.

As early as 1971, unemployment pension was introduced in the statutory earnings-related pension scheme. At the time, many elderly unemployed persons had difficulties finding employment and the period entitling to unemployment benefit was short, for which reason the means of living were running short for many. To guarantee elderly unemployed people an income of more permanent nature before retirement age, the unemployment pension was introduced. In response to the rise in the rate of unemployment for the elderly, especially, witnessed in the late 1970s, the qualifying age for unemployment pension was lowered from 60 to 58 years, and further to 55 years in 1980. The qualifying age remained at 55 until 1986, after which it was gradually raised back to 60. At the same time, a decision was taken to shift on responsibility for unemployed persons under the age of 60 to the unemployment security plan. During the boom years at the turn of this decade, the 1990 Pension Committee suggested abolition of the unemployment pension. This suggestion did not, however, materialise, mainly because the rate of unemployment had started to go up again. However, the period of unemployment benefit required to qualify for unemployment pension was extended from 200 to 500 days.

Against this background, political decision-makers and trade union activists could be expected to try to use the statutory earnings-related pension scheme as a tool for reducing the unemployment rate.

2. Suggestions

Since 1993, several proposals (including initiatives by Parliament) to lower pension ages temporarily have been made in order to reduce the rate of unemployment for younger people. These proposals have been publicly debated, but so far they have not been carried out.

Earlier it was suggested that an employee aged 55 or over could be granted a pension of the same level as the disability pension, provided that an unemployed person under age 30 was employed in his place. Later suggestions include the right of people with a working career of at least 30 years to choose to take a pension from the age of 55 and over. Such people would receive the pension accrued by the time of retirement (the pre-contingency period) but the pension would not be projected to retirement age (the post-contingency period). The earlier suggestions are referred to as shift-of-generation pensions, whereas the later suggestions are called voluntary early retirement pensions.

The pension benefits suggested may look cost neutral. They may even be perceived as generating savings for the economy as a whole. And they are also socially acceptable, in that they give elderly tired and exhausted persons a chance to retire and young people an opportunity to work. However, the practical implementation of the suggestions may produce rather surprising effects and have far-reaching and highly unexpected consequences for the pension scheme. In the following, the situation in the labour market and in the field of social security is first presented. This presentation is followed by an analysis of the consequences of the later suggestions for the labour market, the pension

scheme and the field of social security as a whole. Many of these consequences are the same also in the case of the earlier suggestions.

3. Labour market and social security situation in Finland

High rate of unemployment especially for the elderly and the young

Still in 1990, the unemployment rate was as low as 3%. It reached its maximum in 1994 at 18% and is now slowly declining. In 1996 the rate was 16% and in 1997 it had further dropped to 14.5%. The high unemployment rate, especially among the elderly (28% of the labour force in 1996 for age bracket 55-59), is a serious problem, and assuming that the rate remains at this high a level, it will come to a head within a few years when the baby-boomers born after the Second World War will reach the age of 55. Employers may often find it easier to give an elderly person notice, because elderly people are, in practice, guaranteed an income from the age of 55 onwards, either in the form of unemployment benefit or pension benefit. Before 1997, unemployment benefit could be drawn from the age of 53 through to the age of 60 and, thereafter, the beneficiary would automatically qualify for unemployment pension payable until retirement age (the unemployment pension pathway). The age limit for entry into the unemployment pension pathway was raised from 53 to 55 at the beginning of 1997, and it may be further raised. Where payment of unemployment benefit is no longer automatically extended until the age of 60 because of the new regulations, the unemployed persons are guaranteed rehabilitation or training or offered an employment contract for ten months to promote their return to gainful employment.

The unemployment rates for young people are as high as for older people. The suggestions would mainly concern young unemployed and elderly employed persons. For the sake of comparison, it can be mentioned that 120,000 persons under 30 were seeking employment in 1996, whereas 150,000 elderly over 55 were employed.

Lower participation in working life among the elderly

Not only in industrialised countries but in many countries throughout the world labour market participation rates among elderly wage earners have declined and are still declining. Today people leave the labour market earlier than two or three decades ago. The set retirement ages of public pension systems around the world are becoming less and less valid as milestones marking the dividing line between the economically active period of labour market participation and the economically inactive period of retirement (Sørensen, 1997).

In Finland, the labour force participation rates among the elderly have changed dramatically since the beginning of the 1960s. In 1963, the rate among men in age bracket 55-64 was 84%, 20 years later it had dropped to 54% and in 1995 it was as low as 46%. The share of employed has decreased even more during the past 12 years, from 51.4% to 34.3%. Of the OECD countries, Finland

ranked second to Spain in this respect, cf. Table 1. In 1983, the ratio was almost 9 percentage points below the average of the OECD countries, while in 1995, in a comparison between the same countries, the share was 18 percentage points below the average and the lowest of all countries. Today only about one-third of both men and women aged 55 - 64 years are still working, a development which is mainly attributable to factors like the deep recession witnessed at the beginning of this decade, the attitudes towards elderly in working life, and several options for drawing a pension (cf. Appendix 1) before retirement age.

Table 1. Employed/population ratios in OECD-countries for men aged 55-64
Percentages

	1983	1995	Change
Australia	59.6	54.1	-5.5
Austria		40.8	
Belgium	47.7	34.5	-13.2
Canada	66.4	54.0	-12.4
Check Republic		50.6	
Denmark	63.1	63.2	0.1
Finland	51.4	34.3	-17.1
France	50.4	38.4	-12.0
Germany	57.4	48.8	-8.6
Greece	68.8	58.9	-9.9
Iceland		89.6	
Italy	36.1	42.3	6.2
Japan	80.5	80.8	0.3
Luxembourg	37.8	35.1	-2.7
Mexico		77.9	
Netherlands	46.1	41.1	-5.0
New Zealand		63.0	
Norway	78.9	70.0	-8.9
Portugal	69.0	58.9	-10.1
Spain	65.2	48.0	-17.2
Sweden	73.9	64.4	-9.5
Switzerland		79.1	
Turkey		59.7	
United Kingdom	64.3	56.1	-8.2
United States	65.2	63.6	-1.6
Average	60.1	56.3/52.6*	

The latter figure represents the average of the countries in the 1983 comparison
(source: OECD Employment Outlook 1996)

The employment situation in Finland has improved somewhat since 1995, but still only 37% of men aged 55-64 were in employment in 1996, 12% were unemployed and about 50% were retired. The figures are nearly the same for women. Combined statistics for both sexes is shown in Table 2. The number of unemployed in age bracket 60-64 is very small because of the automatic entitlement to unemployment pension from the age of 60 following a period of unemployment benefit. If those drawing unemployment pension are considered as unemployed, the ratio of unemployed represents around 20% for the whole age group as well as for both subgroups, as shown in Table 2.

Table 2. Population aged 55-64 by activity in 1996

% of population		Age	
Both sexes	55-59	60-64	55-64
Employed	48.5	19.0	34.8
Unemployed	18.6	3.7	11.7
Retirees, all	27.9	72.1	48.4
- on unemployment pension	-	16.9	7.8
Others	5.0	5.2	5.1
Population	100	100	100

(Sources: Labour Force Survey of Statistics Finland and Statistical Yearbook of Pensioners in Finland)

Higher expectation of life

Life expectancy at age 50 has increased by 5 to 6 years during the past 30 years, while the average effective retirement age has dropped considerably over the same period, although the health of the elderly is improving and the elderly people are better educated than the generation before them. This phenomenon is to some extent a paradox. As a consequence, the period of retirement has been drawn out at both ends, and the cost arising from the retirees has increased much more than originally envisaged.

Trends discernible in Finnish pension policy

During the 1970s and 1980s, there seems to have been general agreement about early retirement in many countries. Against the background of growing unemployment and economic recession, governments and labour market organisations have a shared interest in early retirement, though based on different motives, and individuals seem to have embraced the idea wholeheartedly (Sørensen,1997).

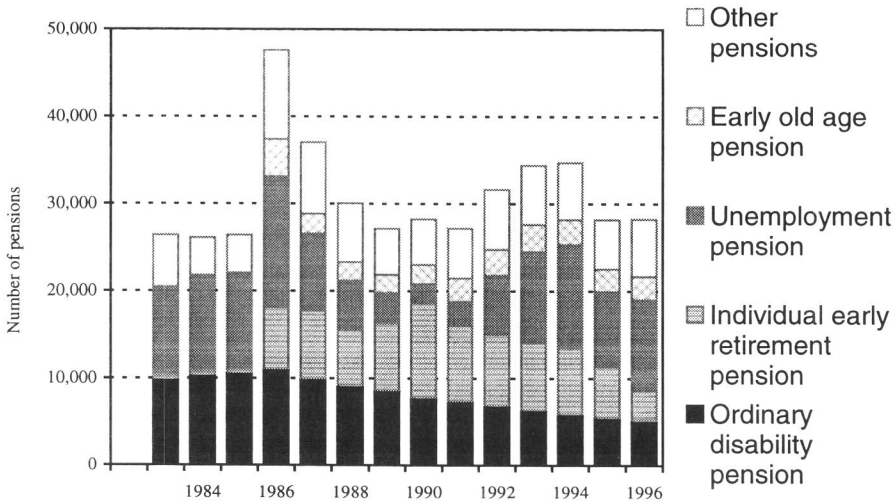
In the 1970s and 1980s, there was constant pressure in Finland for lowering the retirement age. During the past twenty years, the trend towards early exit from work has been very strong. People have either retired directly from the labour market or taken the unemployment pathway. Despite the reforms and decisions to promote longer working careers, early exit from the labour market is still normal practice in Finland and a shift of generation at workplaces in the manner suggested would only contribute to keeping up early exit practices. Hence, the presentation of the trends and ideas surrounding retirement practices during the past decades.

In 1971, the unemployment pension was introduced for long-term unemployed persons over the age of 60. When the employment situation deteriorated at the end of the 1970s, the minimum qualifying age for unemployment pension was temporarily lowered from 60 to 58 years. A couple of years later it was further lowered to 55 years. In the late 1970s, a pension committee was set up to prepare a reform of pension ages. At the time it was feared that the excessive supply of labour would be long-standing. Until then, lowering pension ages had been considered as a tool for dealing with unemployment. When a position became vacant through someone taking early retirement, it was assumed that it would be filled. However, this was not self-evident, as it turned out. Instead, measures of rationalisation were often taken and people who were fit for work were redeployed into retirement and a reshuffle within the enterprise was organised. Hence, the pension committee also considered that lower pension ages could not be motivated by considerations of employment policy. On the other hand, a lower retirement age based solely on occupation was not flexible enough, because the character of the work often changed in the long run and sometimes the work even turned lighter. The committee therefore suggested that, in lowering pension ages, the primary importance should be attached to the individual effects of ageing and sickness. As a result, in the late 1980s, flexible pension age arrangements were introduced, including three new, complementary pension benefits: individual early retirement pension, early old age pension (actuarially reduced pension) and part-time pension (cf. Appendix 1). Originally, the minimum qualifying age was 55 years for individual early retirement pension and 60 for the other two pension benefits.

The idea behind the introduction of flexible pension ages was to allow people to retire individually as people grow old differently. The part-time pension and the early old age pension have not been very much used, whereas the individual early retirement pension has become very popular. When the minimum qualifying age for unemployment pension was gradually raised back to 60 in the late 1980s, some cohorts could qualify for either individual early retirement pension or unemployment pension before the age of 60. In the statistics, this fact is reflected in an extremely high number of new pensioners. As a result, the average effective retirement age has remained around 58-60 years for the past 10 years, and considering the very high unemployment rate, especially among the elderly, it is not expected to rise during the next few years. One-fifth of the population aged 55-59 is unemployed and most of them will be entitled to unemployment pension at the age of 60, provided they remain unemployed.

Figure 1 shows the number of new pensions awarded in 1983-1996 to people in age bracket 55-64. It also illustrates a drop in the number of individual early retirement pensions awarded during the past few years. This is due to the gradual rise in the minimum qualifying age from 55 to 58, with the cohort born in 1938. On the other hand, a boom is to be expected in 1998, when the first new cohort in three years will qualify for individual early retirement pension.

Figure 1. New pensioners in age bracket 55-64 in the private sector



Ever since the turn of this decade, the aim of Finnish social policy has been to increase the labour market activity of the elderly

Since the late 1980s, the policy has been to encourage people to stay longer in working life. This has been called for by the rapidly declining labour market activity of the elderly and the impending shortage of labour after the turn of the century. Special attention has been focused on maintenance of the work capacity of the population of working age and on measures of rehabilitation and training. The policy is also to encourage retired people to return to gainful employment temporarily or permanently. In addition, partial pension benefits are given preference over full-time benefits.

Two large pension reforms were carried out in 1993-1996 to prevent an impending rise in the pension contribution and to both encourage people to continue working and reward those who do. As an incentive to longer labour market activity, elderly employees over 60 are rewarded by a higher accrual rate. Furthermore, the annual accrual rates are reduced for early retirees and disabled workers, a sort of guarantee pensionable wage is applied to elderly workers with a long employment history, and rehabilitation measures are encouraged. In addition, the minimum qualifying age for individual early retirement pension was

raised to 58, whereas the qualifying age for part-time pension was lowered from 60 to 58. In an experiment, the qualifying age for this pension will be further reduced to 56 as of July 1998 and will remain reduced for two years. There is still pressure for further changes. The reform of the unemployment security plan of 1997 was also aimed at promoting employment opportunities for the elderly. The increase in life expectation may also, before long, warrant a rise in the general retirement age of 65. There is general agreement among pension experts (Varoma et al 1997) that the general retirement age will be one of the key issues in the development of the pension scheme in the near future.

Unfortunately, the economic depression interfered with the amendments made, and it is acknowledged that the reforms cannot be successful, unless the unemployment rate for the elderly falls and the labour market participation of the elderly increases. The unemployment rate for the elderly is partly dependent on the economic development (surviving the economic crisis), and the labour market participation of the elderly is partly dependent on adequate measures of early rehabilitation and better provisions of pension to those who stay at work compared to those who take early retirement. Nevertheless, the attitude to elderly employees must also change. Several national programmes to keep elderly workers employed or to encourage their return to the labour market have been implemented in the 1990s. A couple of years ago, in December 1995, the Finnish government set up a committee to investigate the situation of elderly in the labour market. The key proposal of this committee was the implementation of the National Programme for Ageing Workers, a plan designed to improve the employment opportunities of the elderly. This programme was launched by decision of the Finnish government in February 1997. The aims of the programme include measures to increase adult education opportunities and to implement part-time pension, job alternation and subsidised part-time employment schemes for elderly employees. The prospects of making changes to pension payments and non-work-related payments by employers will also be explored, with the purpose of lowering the threshold to hiring elderly workers.

4. Consequences for the labour market

Encouraging as it may be to look for ways of dealing with the high rate of unemployment, especially among the young, the suggestions for temporarily legislating lower pension ages as a means of reducing unemployment totally contradicts the aims of the National Programme for Ageing Workers and any other programmes designed to promote longer working careers. The suggestions to temporarily lower pension ages mean that the proportion of people working beyond 55 will further decline from the current extremely low level of one-third. This would mean that the increase in longevity would coincide with shorter periods of active employment. From the labour market point of view, the suggestions to lower pension ages temporarily would only result in seemingly lower unemployment rates, but no new workplaces would spring up. At best, it could only result in a change of people in already existing jobs.

As the thought behind the suggestions is to create jobs for those who are unemployed, the natural implication is that anyone retiring on a shift-of-generation or voluntary early retirement pension should exit work permanently. In the present economic and labour market situation, a person aged 55 years could commit himself to retiring from work completely. Later, if circumstances change and the retiree wants to return to gainful employment but cannot do so, the consequence may be an expanding informal economy.

The aim of the proposals is to reduce unemployment. According to a number of national studies, the effectiveness of early retirement in combating unemployment is limited because the intended redistribution of unemployment does not occur to a satisfactory extent. A number of national studies show that a large proportion of the jobs vacated by workers taking early retirement are not reoccupied by younger workers. Levels of re-employment vary across countries, but are often low, and it is thus argued that this strategy seems to be of limited effectiveness. It certainly reduces unemployment among older wage earners, but it does not increase the employment prospects of the young (Sørensen, 1997).

In Finland, the effect of early retirement on employment figures has not been properly investigated. A survey (Jääskeläinen-Lundqvist, 1983) was however made at the beginning of the 1980s. The survey found that special pension arrangements resulted in employment opportunities for younger unemployed persons in about half the cases. In the 1990s, the effect would be much smaller because of the strong rate of productivity growth (Rantala, 1997). A study of part-time pensions (Takala, 1996) supports this conclusion. Of those shifting over to part-time pension, only 15% reported that new people were engaged for the part-time jobs vacated.

The efficiency of the proposals can be examined by estimating the minimum cost of each employed person. It can be assumed that no more than half of the jobs vacated by those shifting into retirement create employment opportunities for the unemployed. Because of the higher replacement rate of unemployment and disability pension benefits, it is assumed that the voluntary pension will mainly attract those employees who do not expect to be eligible for either unemployment or disability pension in the next few years. The salary payable to the elderly in Finland represents, on average, around FIM 130,000 a year, the social security cost of younger unemployed persons is approximately FIM 50,000 per year, and the voluntary early retirement pension represents approximately 50% of pensionable earnings. Using these assumptions, the additional cost of each employed person during the first few years would represent around FIM 40,000 a year and the total future cost would be around FIM 140,000, which is nearly three times the approximated average yearly cost of a young unemployed person. At this cost, there would be no new workplaces. At best, the suggestions would result in a change of people in already existing jobs. Thus, the materialisation of these suggestions cannot be supported in financial terms.

5. Analysis of the consequences for the pension scheme

Conflicts with the trends in both pension and unemployment policy

In developing both unemployment and pension plans, the aim has been to give people an incentive to continue working and to encourage retirees and unemployed people to return to gainful employment. This was the target of both the pension reforms carried out in 1993-1996 and the reform of the unemployment security plan implemented in 1997. Introduction of a voluntary early retirement pension would be in conflict with these aims. It would mean that people over 55 who are healthy and fit for work would be granted a pension, which is totally incompatible with the purpose of social politics, i.e. to encourage both disabled and unemployed people to return to gainful employment by offering them rehabilitation and training and by making legislative amendments.

Measures that started out as temporary have proved to be long-standing

The proposals to lower the retirement age are meant to be temporary. In practice, however, they have turned out to be long-standing. The minimum qualifying age for unemployment pension was temporarily lowered seven times between 1978 and 1985. Furthermore, both the earlier low minimum qualifying age for individual early retirement pension and the automatic extension of the period of unemployment benefit until the age of 60 for unemployed people over the age of 55 can be considered as consequences of the previous low minimum qualifying age for unemployment pension. The temporary lowering of the minimum qualifying ages have had adverse effects on the pension scheme and on the whole field of social security. Such measures keep up expectations of low pension ages and early exit from work.

In practice, pathways out of work already exist for those over 55

Because of the poor employment situation, employees over 55 may, in practice, avail themselves of the opportunity to exit work voluntarily, receive unemployment benefit until the age of 60 and after that be automatically entitled to unemployment pension payable until the general retirement age of 65. The unemployment pathway is more profitable than the voluntary early retirement pension suggested. The earnings-related unemployment benefit for average earnings plus or minus 20% corresponds to a pension level of approximately 50-60%, and the unemployment pension can never be lower than the suggested pension because the period of unemployment and the time between pension contingency and the general retirement age is counted as pensionable time. Because of the higher replacement rate of unemployment and disability pensions, the number of people retiring on these pensions is not expected to change remarkably. The voluntary early retirement pension suggested would, therefore, mainly be an additional pension benefit in the wide range of already existing pension benefits.

The argument for counting the post-contingency period for elderly as pensionable time should be closely examined

Disability and unemployment pensions are projected to retirement age, provided that pension contingency occurs while the person is employed or within a year of the termination of employment. Any periods during which the applicant has received sickness or unemployment benefit extends this time.

The voluntary early retirement pension suggested would not be projected to retirement age. At first thought, it sounds reasonable that a voluntary pension is granted at a lower level. On closer examination, however, the pension level suggested questions the justification in projecting unemployment pensions to retirement age. One cannot but question the legitimacy of a scheme granting a higher pension to those who are unemployed before occurrence of pension contingency than to those who are granted a voluntary pension on leaving service with the specific purpose of reducing the unemployment rate. Further, if, as assumed in the proposals, the level of pension corresponding to the pension accrued is high enough for an adequate subsistence, what arguments are there any more for projecting any pension granted *near the general retirement age* to retirement age? Exclusion of the post-contingency period from the pensionable time would eliminate any doubts about whether working near retirement age is profitable or not in respect of the amount of the pension benefit. A step in this direction was already taken in the 1996 pension reform, when the annual accrual rates were reduced for early retirees (cf. Appendix 1).

The gradual implementation of the pension scheme has been presented as an argument in favour of projecting the pension to retirement age, but in a few years' time when the scheme attains maturity this argument will no longer be valid. It can be argued that if early retirement is forced rather than voluntary, the pension should be projected to retirement age. On the other hand, the distinction between forced and voluntary early retirement similarly as that between disabled and non-disabled wage earners narrows off near retirement age, and under the prevailing conditions of mass unemployment the elderly wage earners may choose whether to continue working or take the unemployment pension pathway.

Actual general retirement age would fall

The general retirement age is 65. In the public sector it was earlier 63 years and still is for elderly civil servants.

Statutory earnings-related pension accrues in age bracket 23-64. As a rule, pension accrues at an annual rate of 1.5% of pensionable earnings. However, for those over 60, the annual accrual rates were raised from 1.5 to 2.5 in the 1994 pension reform. The target, or maximum amount, of the pension represents 60% of the wage and it used to accrue in 40 years. Because of the higher accrual rates introduced for the elderly, the maximum pension may today already accrue in 36-37 years. In the public sector, the target of the earnings-related pension earlier represented 66% of the wage and it accrued in 30 years.

The rules for the public sector were changed in 1993-1994 but the old rules still fully apply for all civil servants who were over the age of 55 in 1995 and partly for those who were between 36 and 54 in 1995.

In the private sector and for younger civil servants, a full 60% pension accrues already by the age of 61 for employees with no career breaks. Correspondingly, a 55-year-old civil servant may already have accrued a full pension according to the old rules in the public sector. As a consequence, a voluntary early retirement pension would result in a lower general retirement age. In the private sector, the general retirement age would be 61-62 years and in the public sector 55 years in the beginning and 56-57 years later. In addition a voluntary early retirement pension would wreck the 1993-1994 reform to gradually raise the general retirement age in the public sector from 63 to 65 years.

Accrued pension promised at normal retirement age

One of the basic principles of the Finnish pension scheme is that an unreduced old age pension is not granted until retirement age, even if a full pension has accrued earlier. There is a huge difference in pension costs between granting a pension at a set retirement age and granting a pension at an earlier age. The early old age pension, where a pension taken earlier is actuarially reduced, very well illustrates the difference between these two concepts. When reducing a pension actuarially, the pension capital expected to be needed for a pension granted at retirement age is first fixed by taking the expectation of life and the discount rate into account. To put it simply, after this an actuarially reduced pension is determined on the fixed pension capital. In other words, an actuarially reduced pension is cost neutral with respect to the pension granted at retirement age (in reality, also the probability of forced early retirement is taken into account).

A pension based on the pension accrued and granted before retirement age is actually a huge advantage. If the proposed pension of the same level as the corresponding old age pension were granted at age 60, it would be about 30-40% higher than an actuarially reduced pension. Correspondingly, a voluntary early retirement pension granted at age 55 would be about 60% higher than a cost-neutral pension.

In practice the early old age pension benefit would disappear

A voluntary early retirement pension would, in practice, cause the early old age pension benefit to disappear. A voluntary early retirement pension granted at age 60 would be 30-40% higher than the corresponding early old age pension, in practice with no additional conditions attached. In principle, the early old age pension may also be awarded after working careers shorter than 30 years, but because of the actuarial reduction a pension of 45% level would decrease to a good 30% and few retirees would live on so low an income. The voluntary early retirement pension would be much more expensive than the early old age pension and it would cause pension costs to increase permanently.

The costs for the pension scheme and for social security at large

Another problem of the Finnish pension scheme besides the low actual retirement age has been the high cost of pensions. So, in the 1996 pension reform pension benefits were cut. The reform brought a balance between pension contributions and pension expenditure both in the short term and in the long term. However, this balance would be disturbed if the proposed pensions were to reduce the unemployment rate considerably. The higher the pension costs, the more marked the reduction in the unemployment rate.

Approximately 60-70% of employees over 55 have a 30-year-long working career after the age of 23. According to a survey (Gould, 1994), as high a proportion as 60% of employed in age bracket 55-64 would prefer retirement to employment, if given the free choice. Because the suggested voluntary pension benefit would be lower than the corresponding disability or unemployment pension benefit, it is not likely that it would be nearly as popular, considering that employees of this age may exit work using the unemployment pension pathway.

The popularity of the voluntary early retirement pension proposed is impossible to predict. Calculations are, therefore, based on assumptions. It is assumed that the pension benefit proposed would not affect the probability of other early retirement pensions. Further, if one in ten of those qualifying for the suggested pension would take it, 10,000 to 17,000 people would shift into retirement annually, which sums up to a total of nearly 100,000 people over a period of seven years. This is around one-fourth compared to the amount of unemployed people. During the first 7 years, pension costs would increase, then slowly decrease and after yet another 7 years some savings would be generated. During the first 10 years, the pension contribution in per cent of wages would rise on average by one percentage point. As a whole, future pension expenditure would represent 4-5% of the current GDP, while savings in other social security costs, such as in the cost of unemployment benefits, would be in the region of half this amount. The net coming cost for such an arrangement would therefore be a good 2% of the current GDP. Further, increasing labour costs tend to increase unemployment.

6. Conclusions

The primary means of improving the economic situation of today are those creating new jobs. The proposals to reduce the unemployment rate for younger people by lowering the pension age temporarily do not create any new jobs. The result would only be seemingly lower unemployment rates and, at best, a change of persons in already existing jobs, while elderly employed people would exit the labour market permanently.

Large-scale unemployment may turn into an aggravating social problem, especially if the unemployment rate remains high. Therefore, the aim of the sugges-

tions, i.e. to give young people jobs, is well worth supporting. Calculations, however, show that financial aspects do not support the suggestions.

The pensions proposed are in conflict with the trends in both pension and unemployment policy. In terms of both pension and unemployment policy, the aims are to give people an incentive to continue working and to encourage retirees and unemployed people to return to gainful employment. The suggested pension could be destructive for the whole pension scheme, as it strengthens people's belief in the justification in taking early retirement. In addition, the actual general retirement age would fall and conflict with other pension benefits. The voluntary new pension would question the justification in projecting pensions to retirement age. Furthermore, an actuarially unreduced pension granted before the general retirement age would, as such, be a noticeable benefit.

The aim of pension policy is to maintain a balance between pension contributions and pension expenditure both in the short term and in the long term. To this effect, pension benefits were recently cut. However, quite opposite to these aims, the better the pension proposed would serve in terms of creating more employment opportunities, the higher the rise in the pension contribution would be. If every tenth entitled to the benefit would take early retirement during the validity of the proposal, the rate of pension contribution would, on average, rise by one percentage point.

The statutory earnings-related pension scheme is based on insurance principles. Using such a scheme to satisfy needs of income transfers based on social policy assistance is problematic and weakens the credibility of the scheme. From the insurance point of view it is highly questionable that pension assets are to be directed to healthy people, who are fit for work, shifting over from employment to retirement before the general retirement age.

Provision of earnings-related pensions in Finland is based on joint responsibility between generations. The credibility and sustainability of the scheme requires that agreements and decisions are not changed to achieve short-sighted targets that are in contradiction with the aims of the pension policy pursued. Admittedly, unemployment continues to be a pressing problem in Finland, but it should be dealt with by means other than pension policy.

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The Finnish statutory earnings-related pension scheme

The object of the Finnish statutory earnings-related pension scheme is to provide statutory pensions based on service in the private or public sector or on self-employment, and to keep the income in retirement on a reasonable level compared to the income during employment. The amount of pension depends both on previous earnings and on the length of the insurance period. Benefits are determined in the same way as under a defined-benefit scheme. In addition, the pension is index-linked both when earned and after retirement.

The private sector employee pension scheme was introduced in the early years of the 1960s, the first targeted old age pensions will be granted at the turn of the century, but not until the 2030s will the pension scheme attain maturity in respect of pension financing. This means that the pension contribution is expected to rise gradually until the 2030s.

The pension benefits cover the social risk situations arising from old age, disability, long-term unemployment for elderly and the death of the family breadwinner. The rules of pension accrual and pension benefits are presented in the following.

Statutory earnings-related pension accrues in age bracket 23-64 and the target, or maximum, amount of pension represents 60% of the wage. As a rule, pension accrues at an annual rate of 1.5% of pensionable earnings. However, for those employed people over the age of 60, the annual accrual rates were raised from 1.5% to 2.5% in the 1994 pension reform and the annual accrual rates for the part of pension calculated on the post-contingency period were lowered from 1.5% to 1.2% in age bracket 50-59 and from 1.5% to 0.8% in age bracket 60-64 in the 1996 pension reform.

In the public sector, the target of the statutory earnings-related pension used to be 66% of the wage and it accrued in 30 years. The general retirement age was 63 years. The rules were changed in 1993-1994 but the old rules still fully apply for all civil servants who were over 55 in 1995 and partially for those who were between 36 and 54 in 1995.

The general retirement age is 65 years. In the private sector, the pension is increased by one per cent for each month of deferral beyond the age of 65, with no upper limit.

Early old age pension may be awarded from the age of 60, but the pension is permanently reduced by 0.5% for each month the pension is taken before the age of 65.

Unemployment pension may be awarded from the age of 60 to job-seekers who have been out of work for a prolonged period (of at least two years) but who have been employed for at least 5 of the past 15 years.

Disability pension may be awarded to an insured person of at least 14 years of age who has suffered loss of work capacity through illness, defect or injury and whose incapacity is estimated to last for at least one year. A full disability pension becomes payable when at least two-fifths of work capacity is lost and a partial disability pension when between two-fifths and three-fifths of work capacity is lost. The partial disability pension is half the full pension. An individual early retirement pension may be awarded to a person with a long working career on less severe criteria of disability but with consideration of social factors. The minimum qualifying age is now 58 years but used to be 55 years.

Part-time pension may be awarded from the age of 58 to employees with long working careers who switch over from full-time to part-time employment. As of July 1998, the qualifying age will be further lowered to 56 years. This is an experiment and it will last for 2 years.

Survivors' pension is payable to the children and surviving spouse of the deceased.

Farmers' early retirement aid is payable to farmers between ages 55 and 64 who give up farming permanently.

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Eläketurvakeskus on Suomen työeläkejärjestelmän lakisääteinen keskuslaitos. Sen tutkimustoiminta koostuu pääasiassa sosiaaliturvaan ja eläkejärjestelmiin liittyvistä aiheista. Tutkimuksissa pyritään monipuolisesti ottamaan huomioon sosiaalipoliittiset, sosiologiset ja taloudelliset näkökulmat.

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Pensionsskyddscentralen är lagstadgat centralorgan för arbetspensionssystemet i Finland. Forskningsverksamheten koncentrerar sig i huvudsak på den sociala tryggheten och på de olika pensionssystemen. Målet för forskningsprojekten är att mångsidigt belysa aspekter inom socialpolitik, sociologi och ekonomi.

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THE CENTRAL
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The Central Pension Security Institute is the statutory central body of the Finnish employment 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.

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