Pensions at a Glance 2019

How does Finland compare?

27 November 2019

Key findings

- While in Finland people older than 65 years have an average disposable income that is 17% lower than for the total population, both old-age income inequality and relative old-age income poverty are substantially lower than in the OECD on average.
- From 2030, the retirement ages will be linked to life expectancy, transmitting two-thirds of improvements in life expectancy at age 65. The normal retirement age will increase to 68 around 2060 against the OECD average of 66. Changes in longevity also directly affect the benefits through the sustainability factor.
- Taking into account those links, the future net replacement rate after a full career at the average wage will equal 64%, above the OECD average of 59%. Finnish people born in 1940 could retire 3 years earlier at 65 with a full pension and a replacement rate of about 68%.
- Pension contribution rates are aligned between most self-employed and dependent workers in Finland. This means that, in principle, the self-employed have the same pension level as employees with similar earnings, while in the OECD on average their pension will be 21% lower after a full career with an income equivalent to the average wage.
- However, the self-employed in Finland have substantial flexibility in assessing what should be their equitable contribution base. If the self-employed earning the average wage set the contribution base at the minimum required level, they can expect a pension equal to only 27% of pensions of employees with similar earnings.
- The minimum income subject to pension contributions for the self-employed is set at 19% of average wage, which means that the self-employed who earn less than this threshold do not accrue any earnings-related pension entitlements.

Twofold link to life expectancy

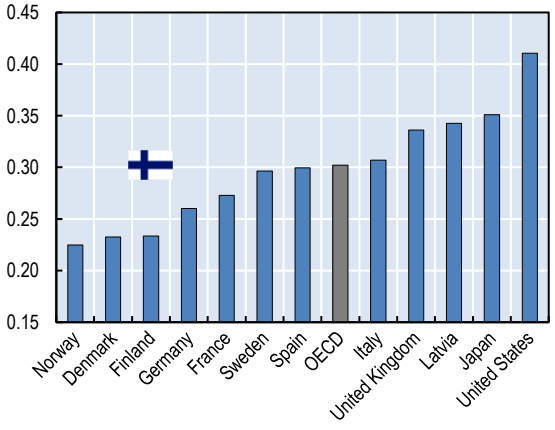
People older than 65 have an average income which is 17% lower than the total population in Finland compared with 13% lower on average in the OECD. However, both relative old-age poverty rates and old-age income inequality are low in Finland. For example, the income Gini coefficient among those aged 66+ is equal to 0.23, substantially lower than the OECD average of 0.30.

Low old-age income inequality in Finland reflects low past inequality among the working-age (18-65) population, although at about 0.31 from 2006 the Gini coefficient is higher than its mid-1980s level of 0.25. Furthermore, the earnings-related pensions for low earners are complemented by two residency-based benefits (national pension and guarantee pension), which together top up earning-related pensions while ensuring a minimum income of 21% of the average wage. However, as these benefits are indexed only to prices, they are likely to fall in relative terms over time, increasing old-age poverty risks.

Between 2020 and 2060, the working-age population (20-64) is projected to shrink by 10% in Finland as in the OECD on average. Other Nordic countries would not experience any decline, but Baltic countries and Poland would have their working-age population fall by more than 30%. During the same period, life expectancy at age 65 is projected to increase by 4 years in Finland, remaining one year above the OECD average. While Finland, along with Denmark and Sweden, currently has relatively high old-age to working-age ratios, it will be below average in 2060.

Old-age inequalities are low in Finland

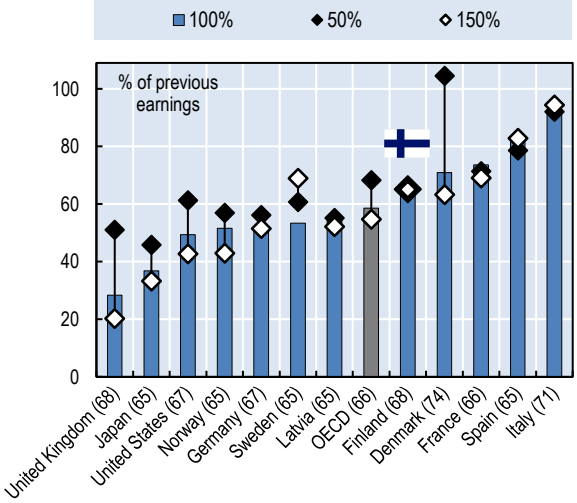
Gini coefficient among people older than 65 years in 2016



Source: [Table 7.4]

Future replacement rates

Net replacement rates for full-career workers earning 50%, 100% and 150% of average-wage



Source: [Figure 5.4].

Finland is among six OECD countries, along with Denmark, Estonia, Italy, the Netherlands and Portugal, linking the legal retirement age to life expectancy. The minimum retirement age in the earnings-related schemes is being gradually raised from 63 and 3 months in 2018 to 65 by 2027. Workers in arduous jobs will maintain the right to fully retire at age 63. For the basic (national) pension, the statutory retirement age will remain at age 65 until 2030 but the option to claim a reduced benefit at 63 will be gradually removed. From 2030, all retirement ages, including for workers in arduous jobs, will increase by two-thirds of life expectancy gains at 65, with the expressed goal of stabilising the ratio of expected time in retirement to time spent working. As a result, the normal retirement age will increase from 65 currently to 68 around 2060, compared with a shift from 64 to 66 on average across OECD countries.

Relatively recently, Finland (since 2010), Japan, Portugal and Spain have introduced sustainability factors in their defined benefit (DB) pensions, which adjust pension benefits to changes in life expectancy. In Finland, the life-expectancy coefficient was 0.957 in 2019, and is projected to fall to 0.867 in 2064, thereby adjusting the DB pension formula by 13.3% in 2064.

At the average wage, the effective contribution rate from mandatory schemes is 24%, much higher than the OECD average of 18%. Moreover, there is no ceiling on pensionable earnings. When accounting for the automatic links to life expectancy, a full-career average-wage private-sector employee entering the labour market at age 22 in 2018 can expect a net replacement rate of 64% compared to 59% on average in the OECD.

In two-thirds of OECD countries including Finland, replacement rates will fall for future generations of retirees, and by 6 percentage points on average. In Finland, the projected decrease is equal to 4 percentage points. As in the Czech Republic, France, Latvia, Portugal and the United States, the increase in the retirement age limits the decrease in pension levels.

Non-standard forms of work represent more than one-third of total employment in both Finland and the OECD. In Finland, temporary and part-time workers account for 17% and 14% of dependent employment, and the self-employed for 13% of total employment. OECD averages are 13%, 15% and 15%, respectively.

As in half of OECD countries, Finland has the same pension contribution rates for employees and the self-employed excluding farmers. However, Finland provides a high degree of discretion in setting contribution bases through a hard-to-verify rule. This rule requires the contribution base to equal the wage that would be paid if the work of the self-employed was carried out by another, equally competent person. By contrast, most countries link the contribution base to the actual income that is validated for tax purposes.

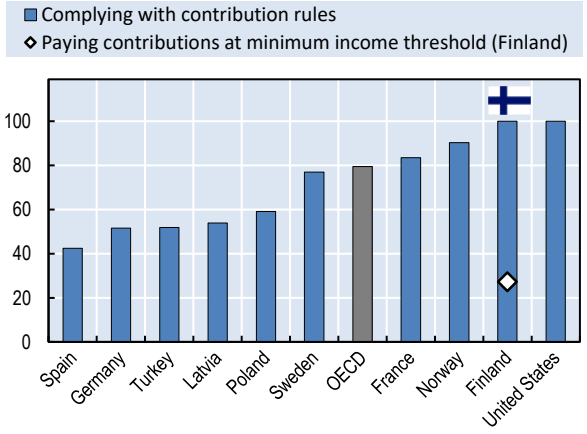
In Finland, the allowed flexibility might result in limited pension protection, especially given that the contribution base can be set as low as at 19% of the average wage. In Latvia, Poland, Spain and Turkey the self-employed can freely set the contribution base within given brackets, but the contribution base must be higher than 40% of average wage. Moreover, in Finland, the self-employed having income below the minimum contribution base are not mandatorily covered by earnings-related pensions.

The self-employed can expect their pensions to equal those of employees with similar income, assuming the contribution base is set consistently with this income level. By contrast, in the OECD on average, self-employed workers will get after a full pension a pension benefit from mandatory schemes equal to 79% of the pension level of employees with similar earnings. However, in Finland, if a self-employed worker having income at the average wage sets the contribution base at the required minimum, the resulting pension will be equal to only 27% of what an average-wage employee can expect. This compares, among countries granting large flexibility to the self-employed, with 42% in Spain and 59% in Poland.

Given the low minimum contribution requirement, it is important to link the contributions to actual income reported for tax purposes or at least to closely monitor whether the self-employed do not set the contribution base much lower than their actual income. Currently among retirees, the former self-employed have a median disposable income equal to 78% of that of former employees against an average of 86% across 14 OECD countries.

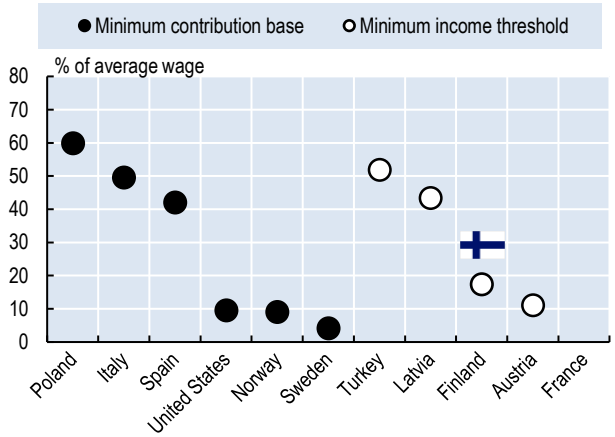
Self-employed workers might receive very low pensions

Gross theoretical pensions of the self-employed as % of employees, with similar careers and earnings



Source: [Figure 2.13].

Minimum income threshold for the contribution base of the self-employed is low in Finland



Source: [Figure 2.11].

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