Increased labour force participation of ageing workers: The case of Finland

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WHY THE FINNISH CASE IS INTERESTING

It is well known that the age structures of the European countries will change in the next decades. As a part of the same change, a new kind of situation is emerging on the labour market. Sooner or later Europe is facing a situation where the number of people entering the labour market will be smaller than the number of people exiting it. In Finland these changes take place sooner than elsewhere. Uncontrolled, this trend would lead to rapid growth of pension expenditure and pension contributions, and would place the burden of the altered age structure solely on the shoulders of younger age classes in working life. This is, as we all know, the main motivation of EU and its member countries to emphasize the need to raise labour force participation rates especially those of ageing workers.

Finland has been quite successful in this effort. This is shown in Figure 1, which presents the development of employment rates of older workers in 1997-2005.

Figure 1. Employment rate of ageing workers (55–64) in Finland and in EU, 1997-2005.

While having an employment rate of ageing workers at the average EU level ten years ago, Finland has succeeded to improve the level from 36 per cent to 53 per cent in 2005. Finland has already reached and exceeded the goal set by the Stockholm European Council 2001 to raise the employment rate of workers in the age group 55-64 to 50 per cent in 2010.

**HOW HAS THIS FAVOURABLE DEVELOPMENT BEEN ACHIEVED?**

This development is an outcome of determined policies, fortunate conditions and their interactions. Favourable economic development since the mid-1990s has contributed to the growth of employment. Pension policies have been a crucial enabling factor. Economic and employment policies have contributed to this development. One contributory factor is the fact that the baby boom generation has had higher labour force participation rates than its predecessors at all ages. Last but not least, Finnish policies to increase the labour force participation of ageing workers have a comprehensive and encompassing quality, including systematic national programmes to facilitate the inclusion of ageing workers in gainful employment.¹

**Economic development**

After the very severe recession in 1990-1993, Finland has had very favourable economic growth rates since the mid-1990s, actually the second highest after Ireland among EU-15 countries. This has certainly contributed to the increased labour force participation of ageing workers, but it is not the whole explanation. For example, in 2003-2004 the overall employment rate decreased, while the employment rate of older workers continued its increase. Figure 2 shows that the employment rate of ageing workers has increased more after the recession than the employment rates of young and middle-aged workers. We have to acknowledge the contribution of economic growth, but other factors, like pension policies, employment policies and policy programmes have also played a role.

**Figure 2. Employment rates in Finland 1997 and 2006 by age.**

![Figure 2: Employment rates in Finland 1997 and 2006 by age.](image)

Source: Labour force surveys, Statistics Finland

¹ For a more thorough analysis, see Ilmakunnas & Takala (2005) and Tuominen (2005).
Employment and economic policies

The vision of the increasing exits and decreasing entries into the labour force, due to demographic change, has deeply affected actions of recent governments in many policy areas. The coalition government of centre and social democrats, which was in power 1999-2003 and 2003-2007, emphasized the improvement of employment rates as a major goal of their policies. For example, the latter government set its main economic policy goal to create jobs for at least 100,000 persons by the end of the electoral period and to pave the way to reach a 75 per cent employment rate by the end of the subsequent four year period. It seems that the government almost succeeded to create 100,000 new jobs. Due to various measures to facilitate the demand in domestic markets, service sectors have established new jobs, but in recent years the number of industrial jobs has increased as well. Unemployment rate has decreased to 7 per cent. Long-term and youth unemployment has decreased, which has been encouraged by various policy measures of the government.

Changes in pension policy as an enabling factor

From the European perspective, Finland realized the importance of policy reforms early, already at the start of the 1990s. Since then, and all the way up to the major pension reform of 2005, amendments have been made to adapt the pension system to the ageing population structure.

Two parliamentary committees (in 1987 and 1990) suggested several reforms aiming to increase years in employment and to cut the foreseen growth of pension expenditure. The recession of the 1990s, the aggravation of financing problems, the ageing of the population, and concern about the sustainability of pension schemes all contributed to the change of direction in pension policy. The increasing popularity of early retirement pensions was seen as problematic. This led to following changes in the pension policy in the 1990s:

As of the beginning of 1994, the minimum age for the individual early retirement pension was raised gradually from 55 years to 58 years; on the other hand, the minimum age for part-time pension was lowered to 58 years. In 1996, other pension income began to reduce the basic amount of the national pension. The method of calculating the wages that form the basis of earnings-related pensions was amended so that wages earned during the last ten years of employment in each employment relationship are taken into account in the calculation; according to the old method, the period was four years. In addition, the index-linking of pensions was reduced, and pension benefits in the public sector were diminished so that they correspond to pension benefits in the private sector. The accrual of pension rights in the case of disability pensions was decreased.

Amendments of the pension schemes have continued in the 2000s:

The most important reform during the history of the earnings-related pension system came into effect in 2005. The long term goal of the reform is to postpone the retirement

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2 Finland held general election in March 2007 and the programme of the new government, formed by Centre Party, National Coalition Party, Green Party and Swedish People’s aim to reach the employment rate of 72 per cent in 2011.
age by two to three years, to adapt the pension system to the anticipated increase in lifetime, and to curb the rise in contributions caused by changes in the population age structure. While in many countries one aim is to raise the age when one can take old age pension, Finland made old age pension flexible between the ages of 63 and 67 years. This is accompanied by an economic incentive: if working is continued after the age of 63 years, the earnings-related pension accrues according to the rate of 4.5 per cent, which is three times higher than the normal accrual rate. The minimum age for early old-age pension was raised to 62 years, the terms of part-time pension were amended, and the individual early retirement pension and the unemployment pension will gradually be abolished. The pension is determined on the basis of earnings during the entire career. The earnings are revalued to the level of the year of retirement by using a wage coefficient that follows trends in the earnings level better than the previously used index. A new feature was adopted in the reform: the life expectancy coefficient, which will be used to adjust starting old-age pensions to the ageing population’s longer lifetime as from the year 2010.

The above said can be summarized as follows. The new direction of the Finnish pension policy is a compromise, where the changes caused by the ageing of the population are not placed on one set of shoulders; instead, they are dealt with by using three or four mechanisms. Firstly, the pension system has been amended so that retirement is postponed. This will help control the inevitable increase in the number of pensioners and the equally inevitable reduction in the number of people in employment. Secondly, the terms of pension provision have been amended. For this reason, the mean pension in relation to wages will fall somewhat in the long term. Thirdly, it has been accepted that ageing of the population will lead to higher pension expenditure. However, the rise in pension contributions will be lower than the rise in expenditure because, in the earning-related pension scheme, not a negligible share of contributions has been funded (more than one fourth in the private sector pension schemes). The yield from the funds is used to cover expenses. The most recent amendment, which came into force at the beginning of this year, aims to encourage investments in stock by earnings-related pension funds. It is believed that this amendment will enable higher returns and will help defuse some of the pressure to raise contributions.

The impacts of the change of direction in pension policy will be seen gradually during the coming decades. It has been estimated that, following the changes made in the 1990s, pension expenditure in relation to the GDP will be about four percentage points lower in 2030 than it would have been if the Acts in force in 1990 had remained unchanged until 2030. According to estimations, the reforms made in the 2000s will reduce the ratio of pensions to the GDP by just under one percentage point by the year 2030. However, the change in the population’s age structure is so great that the ratio of pensions to the GDP will climb from the present level of a good 11 per cent to about 15 per cent in 2030. The relative level of earnings-related pensions (the relation between the average earnings-related pension and the average level of earnings during the same year) is estimated to rise for some years after 2005 until the slight downturn envisaged for the latter half of the 2010s (Biström et al. 2005; Hietaniemi et al. 2006).

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3 The statutory earnings-related pension scheme for private sector workers started in 1962, and from the very beginning this scheme has been partly financing a pay-as-you-go scheme. This is one of the peculiarities of the Finnish first-pillar pension scheme.
When planning of the 2005 reform, it was estimated that the reforms of 1990s and 2005 clearly contribute to the increase of labour force participation of ageing people. In the long run, the expected effective retirement age in the Finnish earnings-related pension scheme will rise by three years, and the labour force participation rate by four percentage units from 68 to 72 per cent (Työryhmäraportti 2002). A study based on a dynamic macroeconomic model including the modelling of the pension schemes suggests that 2005 reform increase the effective retirement age by 1,5 – 2 years (Lassila and Valkonen 2005), while a study based on stochastic life cycle model including pension rules, unemployment benefits and income taxation suggests that the effect of 2005 reform might be 0,7 – 1,5 years (Hakola and Määttänen 2007).

Figure 3. Expected effective retirement age in the Finnish earnings-related pension scheme 1996-2006.

Source: Finnish Centre for Pensions

Indeed, the trends identified in retirement and in continued working since the latter half of the 1990s have been in line with the goals set in pension and employment policies. As shown in Figure 3, the expected retirement age of a 25-year-old person rose by 0,7 years and the expected retirement age of a 50-year-old person by 0,9 years in 1996-2006.4 The same development is also seen in the increased labour force participation of ageing workers, as seen in Figure 3. This figure shows how the employment of ageing workers declined considerably between 1989 and 1995 due to recession, but it also shows a huge improvement between 1995 and 2006.

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4 The calculation of the expected effective retirement age is based on retirements risks of one-year age groups and following the same logic as the calculation of life expectancy, neutralizing the effect of changing age structures. See Kannisto 2006.
Focus on the quality of work life

It is important to realize that the reforms of pension policy are only one enabling factor to encourage longer work careers. Much depends on the quality of work life. In Finland, this observation has been the starting-point of many large-scale programmes aiming to improve the quality of work especially for ageing workers.

Reforms in working life help boost employment and productivity and thus make it easier to respond to the demographic challenge. Good working and functional ability of the labour force provides the foundation for a longer working life, a higher employment rate and rising productivity. If jobs are fitted to the expectations of workers, they are likely to work longer. In turn, higher employment, good jobs and improved productivity strengthen economic growth and thereby the financial base for welfare.

Finland has invested in active ageing for a long time now. Programme for Ageing Workers 1998-2002 was implemented by the Government, social partners, NGOs and several ministries. In this programme, systematic attention was directed towards improving the working and functional ability of ageing workers and striving to promote more favourable attitudes to ageing employees. In particular, the programme focused on the maintenance of working capacity, age management and life-long learning. (The National Programme for Ageing Workers – Evaluation 2002). It is likely that the programme increased more favourable attitudes towards older workers, and contributed to the increase of the proper age of retirement in the public opinion (Työeläkeasenteet 2004).

This programme has been continued by another programme launched by The Ministry of Social Affairs and Health: Promoting the attractiveness of working life 2003-2007.
Its objective is to maintain and promote the attractiveness of work and working life. It is a programme for well-being at work and extending working life supporting research and establishment of good practices. The main responsibility for the programme is carried by the Ministry of Social Affairs and Health, but includes many actors, governmental, social partners, NGOs and research institutes (Longer careers? The Veto Programme Indicators 2006).

In 2006, Finnish policies to facilitate the inclusion of ageing workers got international recognition when The Bertelsmann Stiftung awarded "Ageing Workers" reform program Carl Bertelsmann Prize. According to the motivation of the prize, particularly commendable in the case of Finland is the consistent national-level strategy and commitment to implementation - both on the part of the government, labour unions and employers and as demonstrated by the level of cooperation among government ministries.

THERE IS MORE TO BE ACHIEVED

The conclusion is that Finland has been relatively successful in increasing the labour force participation of older workers. This has been achieved by comprehensive policies, integrating important pension policy changes which seem to work in an anticipated way and which encourage workers to continue in work instead of withdrawing their labour supply. Economic policies have relied on the growth of domestic demand and on the favourable conditions of export industries. Employment policies have aimed to decrease long-term and youth unemployment. National programmes to improve the quality of the work life and health and functional capacity of older workers have paved the way to improved labour force participation of older workers. Finally, and partly as an outcome of these measures and partly as an outcome of favourable international economy, Finland has enjoyed relatively high economic growth rates.

But there is more to be achieved. While the employment rate of ageing workers in Finland has approached that in other Nordic countries, it is still lower than in Finland’s neighbouring countries. Especially, there is much to be achieved to improve the employment of people over 60 years of age. Although their employment rate has risen rapidly during the last few years, it is still low when compared to younger age groups and to the other Nordic countries. Pension reform 2005 can make further achievements here: People over 60 are the primary target group of the pension reform measures that aim at extending people’s working careers. The rise of two years in the minimum age of early old-age pensions and better incentives to encourage people to continue working until the age of 68 years can be expected to rise the effective retirement age also in the future. In line with the main argument of this paper, this can be achieved only if economic development continues favourably and supports the growth of employment rates.

Employment statistics exaggerate the difference between Finland and Sweden, since part-time employment and absence from work due to sickness and other reasons is much more common in Sweden than in Finland, where full time jobs are more common. This means that in terms of the supply of labour hours the differences is much smaller than the one displayed in Figure 5 (see Hytti 2006 for a thorough analysis of Nordic countries).
REFERENCES

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