Promoting Employment among Ageing Workers: Lessons from Successful Policy Changes in Finland

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Among EU15 countries Finland has witnessed the largest increase in the employment of ageing workers since the late 1990s. In these years there was a rapid change from the policy of promoting early retirement to the policy of promoting staying at work. Furthermore, this rapid shift to a restrictive early exit policy took place in a situation that was especially demanding due to exceptionally high unemployment among elderly employees. This paper considers why and how the Finnish policy has been successful earlier than other EU countries in encouraging ageing workers to stay on at work. We argue that the positive change in employment is an outcome of the interplay between favourable economic trends and wide-scale work promotion measures. These work promotion measures include the restrictive changes in early retirement schemes. A severe recession in the early 1990s is an important background factor both for the increased need for reforms in the early retirement schemes and also for making the reforms politically more acceptable.

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Introduction

Throughout Europe, there is a concern about how to encourage people to stay on at work for more years. Raising the employment levels is the crucial element for making the EU the most competitive economy in the world over the decade 2000–2010. In addition to the target for the overall employment rate (70 per cent by 2010), particular goals are set for raising the employment rate for ageing persons. The aim, set at the Stockholm European Council, is to raise the employment rate for 55–64 year-olds to 50 per cent by 2010.

The target for the employment of older workers has recently been reached in Finland, although the overall employment rate has decreased somewhat in 2003–2004 and is some three percentage points below the target level. Finland has actually witnessed the largest increase in the employment of ageing workers since the late 1990s among the EU15 countries. In this respect, one can argue that Finland has been the best performer in the EU, and lessons from the Finnish case should be considered.

Explanations for a positive development of this type are naturally of prime interest. The role of policies is a question that needs to be addressed in particular. It is quite obvious that favourable economic conditions cannot be the sole explanation for the sharp rise in the employment among ageing workers in Finland. The rise in their employment is so much greater than in the population at large that the reforms of

early retirement schemes have undoubtedly played a strong role. Accordingly, this gives us reasons to have a closer look at the reforms and their effects.

In Finland, the change from a policy promoting early retirement to that of staying at work has been rapid. The unemployment pension scheme was created in the early 1970s, but other early retirement schemes (individual early retirement pension, early old-age pension and part-time pension) were introduced in the 1980s. Early retirement schemes were targets for changes aiming to reduce their popularity as early as the 1990s. This policy has now been 'finalized' in the pension reform of 2005, whereby two schemes (unemployment pension and individual early retirement pension) are abolished.

It may be surprising that in Finland the rapid shift towards restrictive early exit policy took place in a situation which was especially demanding due to exceptionally high unemployment. The severe recession in the early 1990s implied deterioration in employment at an unparalleled speed. The latter half of the 1990s was a period of rapid economic growth, but mass unemployment remained a severe problem, especially among ageing workers with low skills. During that period, new entrants obtained most of the new jobs in the expanding sectors, while the unemployed were less successful. The golden era of early exit policies came to an end in a situation where a strong temptation arose to resort to early retirement as a solution.

The aim of this paper is to explain why and how Finland has managed to encourage ageing workers to stay on at work before other EU Member States. Next section describes the situation of the ageing population in the labour market since the beginning of 1990s. The subsequent section provides a more detailed analysis of the changes in the exit channels during this same period. As the role of the policy changes is of prime interest, the forthcoming section reviews the question of how the reform policy became possible. The penultimate section discusses prospects for the future, and especially the likely effects of the latest pension reform in the light of recent studies. Finally the concluding remarks are given.

Ageing workers in the labour market

Employment rates have risen rapidly

The rapid increase in the employment of ageing workers has taken place since the mid-1990s (Figure 1).¹ This rise is especially pronounced at ages 55–61 years. In less than a decade, the employment rates for those aged 58–60 years have risen by about 20 percentage points. In comparison, the change in the employment rate among those over 61 years is much more modest, although the employment rate of 60–64 year-olds has increased more than that of 30–54 years-olds (Table 1). The modest increase in the employment of over-60 year-olds indicates that the employment of this age group will be the target for future improvements.

¹ It is also interesting to note that, in 2004, the employment rate for 50–59-year olds even exceeded the rates of 1989, which represents the period with strong economic growth prior to the recession. It can be concluded that strong economic activity in itself is not a guarantee for higher employment for these age groups.

Figure 1. Employment rates in 1989, 1995 and 2004. *Source:* Labour Force Survey, Statistics Finland.

Table 1 Employment rates in 1995 and 2004

	1995	2004	Change
30–54	77.7	82.1	4.4
55–59	48.9	65.7	16.8
60–64	18.5	29.2	10.7

Source: Labour Force Statistics, Statistics Finland.

As the rise in employment among middle-aged employees (here 30–54 years) indicates, the overall labour market conditions were favourable in the second half of the 1990s in particular. The increase in employment is largely explained by a strong and sustained cyclical upswing during the post-recession period, when the average growth rate of the Finnish economy was the second highest among the EU Member States, after Ireland. However, the difference between ageing and middle-aged employees also indicates that the rapid economic recovery cannot be the only explanatory factor behind the rising employment among those aged 50–64 years.

Finland, like most other EU Member States, has adopted many measures to raise employment rates. The relevant question has been to choose the best policy “package”. At the level of the national economy, this package has contained such broad elements as tight fiscal policy, moderate wage increases and reductions in income taxation. In addition to these policy elements operating at the macro-level, Finland has introduced various work-promotion programmes, such as the National Program on Ageing Workers (1998–2002). The programme had an important role in making attitudes more favourable towards ageing workers using “soft” measures. The programme consisted of comprehensive information and training projects carried out in different administrative sectors. Social partners were also actively involved in its administration.

It is naturally very difficult to evaluate the employment effects of a programme of this type whose main aim is to change attitudes towards, and increase awareness of, issues related to ageing. This is not, however, to say that these kinds of efforts are of no use, but their role can also be seen as a manifestation of a “cultural shift” or “paradigm shift”.² They can thus be considered necessary steps to more concrete policy changes.

In Finland, pension provision is an area of special interest for labour market organizations. Pension provision is based on legislation, but the main principles and pension reforms are mostly agreed upon in negotiations between labour market organizations.³ This also holds true for the early retirement schemes. Accordingly, the necessary precondition for the change in the early exit policy has been a consensus among the social partners on the need for the reform policy. One can argue that the restrictive changes in early retirement schemes are the most concrete evidence of a paradigm shift towards longer working careers, instead of using early retirement schemes as a solution to the unemployment problem.

When the employment policy consists of many simultaneous measures, it is difficult to isolate the “true” effects of a particular element of that policy package. This is especially the case when the policy changes are incremental, such as the changes in the early retirement schemes. However, the difference between the employment trends of ageing and middle-aged workers is clear evidence of the positive employment effects of these changes. The OECD⁴ also came to the same conclusion: the strong pick-up in the employment rate of ageing workers is partly the consequence of the strong upswing in the economy, with the remainder mainly explained by changes to the early retirement schemes.

The age groups displaying the highest increase in employment are those most affected by the restrictive changes in the early exit options (see the section on early exit). The relevant changes include, in particular, increases in the lower age limits for the so-called unemployment pension pipeline and individual early retirement, a disability pension with less strict medical criteria than the standard pension (see footnote 12).⁵

The crucial role played by the lower age limits is partly explained by the fact that the benefits of early exit channels typically lack actuarial adjustment. As a result, those who are likely to use the exit pathways have an incentive to start accumulating the benefits as early as possible. This explains the importance of the lower age limit, as the individuals are not motivated to postpone entering the pathway.

Research evidence based on micro-econometric analysis also indicates that, at least during a period of economic growth, reforms dealing with the quantity restrictions in the early exit channels (the changes in the age limits) have a positive effect on the employment level of ageing workers. Kyyrä and Wilke⁶ found that raising the lower age limit for the unemployment pipeline clearly lowered the unemployment risk of

² See Arnkil *et al.* (2002).

³ See Ilmakunnas and Vanne (2004).

⁴ OECD (2004).

⁵ *Ibid.*

⁶ Kyyrä and Wilke (2004).

those affected by the change in question. In connection with the reform, the lower age limit for the unemployment tunnel was raised by 2 years (from 53 to 55 years) in 1997.

Part-time pensions and part-time employment have become more popular

Finland has traditionally been a country where only a small minority of employees work part-time. In 2003, just 13 per cent of employees – 9 per cent of men and 18 per cent of women – worked on a part-time basis. This is clearly less than the average in EU Member States. However, the share of part-time employment has increased somewhat during the last decade. One obvious reason for this is the increase in the popularity of part-time pensions (Figure 2). A part-time pension can be granted to an employed person who changes from full- to part-time employment (the working hours for part-time employment should be a minimum of 16 h and a maximum of 28 h per week), and the amount of part-time pension is 50 per cent of the difference between the full- and part-time earnings. The scheme was already introduced in the late 1980s, but its popularity increased rapidly only in the late 1990s. The lower age limit for the scheme was then temporarily lowered from 58 to 56 years, and this change clearly increased the popularity of the scheme.

Currently, the share of part-time pensioners is about 25 per cent of 60–64-year-old employees. This is a large share with many important implications. The increase in part-time pensions and part-time employment naturally implies that the number of hours worked is growing at a slower rate than the number of employees. However, there are also implications that have brought welcome changes to the labour market. Part-time employment has typically concentrated primarily on certain sectors, such as

Figure 2. Employment rate and part-time pension (age groups 55–59 years, 60–64 years). *Source:* Labour Force Survey, Statistics Finland & Pension Statistics, Finnish Centre for Pensions.

commerce, the hotel industry and catering, and has been particularly widespread among women. The increase in part-time pensions has helped to break these traditional patterns. Men are nearly as likely to enter part-time retirement as women, and its increased popularity has brought more flexibility in working times even in sectors where part-time work has previously been uncommon.

The share of involuntary part-time work has been very high in Finland when international comparisons are made⁷ – a third of part-time workers have chosen the working time pattern involuntarily. By contrast, those in part-time employment through the part-time pension scheme are satisfied with their working times.⁸ One can therefore argue that the growth in part-time pensions is helping to create a practice whereby part-time employment increasingly occurs on a voluntary basis.

The OECD has criticized the Finnish part-time pension system for reducing the effective labour supply.⁹ This criticism is based on the findings of a study proving that a large share (about 50 per cent) of part-time pensioners would have continued in full-time work in the absence of a part-time pension scheme.¹⁰ Furthermore, a recent survey indicates that those on part-time pension are not planning to retire any later than those working full-time.¹¹ The discussion indicates that the effects of a scheme of this type are diverse in the labour market. In reforming the system, the final conclusions should be based on the effects of both quantitative and qualitative issues.

Unemployment remains a severe problem among ageing workers

During the recession of the early 1990s, the unemployment rate skyrocketed by 13 percentage points in four years, from 3.2 per cent in 1990 to 16.6 per cent in 1994. Unemployment especially affected the 55–59 age group, for which unemployment also became a persistent problem at an individual level.

Finland belongs to the group of countries where unemployment-linked benefits (UI and unemployment pension) can be used to bridge the time until people enter old-age pension.¹² The importance of this exit pathway clearly increased in the severe recession of the early 1990s. The risk of unemployment increased disproportionately for the group of ageing workers eligible for extended unemployment benefits, and they suffered the least financially from the loss of employment (Figure 3).¹³

⁷ See for example Corral and Isusi (2004).

⁸ Takala (2004).

⁹ OECD (2004).

¹⁰ Hakola (2002); Takala (2002).

¹¹ Takala (2004).

¹² Currently, those who become unemployed at the age of 55 years or over can receive earnings-related unemployment benefits until the age of 60 years, after which they can receive unemployment pension. Under the pension reform of 2005, unemployment pension will be eliminated, but extended unemployment benefits are paid to those who become unemployed at the age of 57 years or over until they are eligible for old-age pension.

¹³ See Hakola and Uusitalo (2004).

Figure 3. Unemployed/population – ratios in 2003. *Source:* Statistics from the Ministry of Labour.

The persistence of unemployment was also caused by the mismatch problem prevalent in the labour market during the recovery years after the recession. Recovery in the sectors which suffered the highest unemployment rates during the recession, such as construction, was slow compared with the rapid growth in new expanding sectors, such as the electronics industry. Accordingly, new jobs were rather different from the jobs lost in the early 1990s, and many who became unemployed during the recession were relatively poor candidates for the new vacancies during the recovery period.¹⁴ Persistent unemployment became a severe problem especially for ageing workers with a low educational background. Currently, ageing workers (55+ years) on extended unemployment benefits (both UI and unemployment pension) constitute a large share (over one-third) of total unemployment (i.e. those registered as unemployed and unemployment pensioners).

The persistence of unemployment is directly linked to the outflow rates from unemployment back into employment. The rates seem to clearly depend on age: the outflow rates for persons in their late 50s are insignificant compared with those for unemployed persons in their late 40s and early 50s.¹⁵ The outflow rates seem to indicate that the effects of the unemployment pipeline are not only restricted to the increased risk of unemployment. For those who have become unemployed, the pipeline seems to bring a development where returning to employment is not a likely event.

Accordingly, the increasing employment rates for ageing workers during the last decade result from declining outflow rates from employment into unemployment, rather than improved employment prospects for the unemployed among the older age groups. In other words, the risk of becoming unemployed has decreased, but once unemployed one is very unlikely to return to employment. Thus, necessary future measures are likely to be different from those adopted so far.

¹⁴ See Koskela and Uusitalo (2004).

¹⁵ Rantala and Rompanen (2004).

Early exit from the labour market

Consensus exists within Finnish pension policy that in order to secure sustainable finances for pensions in the future, the working careers must be extended. This does not only mean entering the labour market at an earlier stage, but particularly supporting ageing employees in staying in working life and curbing early retirement.

When the older workers exit working life in Finland, they mainly retire and leave work permanently. Ageing employees who become unemployed are not likely to be re-employed, and this is also the case with those taking full-time early retirement.¹⁶

As a result of the recession of the early 1990s, unemployment rose to unprecedented levels in Finland and the employment opportunities for older unemployed persons became very scant. At the time, the unemployment pension became the primary channel for ageing employees to exit working life.¹⁷ In this way, the unemployment pension changed from a marginal instrument of early exit policies to one of the main pathways leading out of the labour market.¹⁸

Attitudes towards the unemployment pension had been very reserved within the pension system, and a proposal had been made to abolish it in 1991 in a report by a committee on retirement age. However, the decision was made to preserve the unemployment pension scheme for the time being, as the livelihood of ageing unemployed persons was a concern during the recession. In the early 1990s, a system comprising daily unemployment allowances and unemployment pension was created and became known as the unemployment pension pipeline.¹⁹ According to Lundqvist,²⁰ the creation of the unemployment pension pipeline and the early retirement opportunities that were broadened in the 1980s actually caused upheaval in the labour market of the over 50s.

Research conducted in Finland²¹ has shown that the existence of the unemployment pension pipeline in itself fostered unemployment of the aged in the 1990s. Regardless of the period under scrutiny, the risk of unemployment of ageing employees is always heightened for those verging on the lower age limits of the pension tunnel. In 1993, the lower age limit for the pension pipeline was 53 years, and unemployment grew stronger for the corresponding age. When the lower limit was raised to 55 years in 1997, unemployment began to increase from the corresponding age upwards. Since 1998, the risk of unemployment linked with the lower age limit of the pension pipeline has diminished.

Disability pension has been another major exit pathway in Finland. Unemployment and disability have alternated as the most common reasons for ageing workers to exit

¹⁶ *Ibid.*

¹⁷ Gould (1999); Hytti (2002).

¹⁸ Gould and Saurama (2004).

¹⁹ The unemployment pension pipeline indicates a situation in which ageing persons who have become unemployed can retain their eligibility for daily unemployment allowance until they reach the age when they are eligible for unemployment pension and then move on to old-age pension.

²⁰ Lundqvist (1996).

²¹ See Hytti (2001).

Figure 4. New pensions in the private sector for persons aged 55–64 years in 1990–2004, according to pension type. *Source:* Pension Statistics, Finnish Centre for Pensions.

working life. Disability pension was at its most popular during the structural changes affecting rural industries at the turn of the 1960s and 1970s and during the full employment of the late-1980s.²²

The number of older persons on disability pension increased significantly at the end of the 1980s, when the disability pension with lowered criteria (individual early retirement pension) was created. The pension was intended for employees over the age of 55 years whose working capacity was evaluated according to sickness, age and work load.

In the early 1990s, the number of persons retiring on disability pension began to diminish sharply, particularly in the oldest age groups (Figure 4). The number of 60–64 year-olds retiring on disability pension decreased by a half from the peak in the 1980s. According to Gould and Nyman,²³ important reasons for the fall in disability pensions for ageing employees were the improvement in the state of health and working capacity of the population, changes in pension criteria and an increase in the importance of rehabilitation.

The number of those retiring on disability pension started to increase to a degree from 2000 onwards. This is partly explained by the ageing of the population, as the baby-boom generation has reached the age which has a higher risk of disability. However, the change in the age structure can only explain some of the increase, as the rise is also displayed in age-adjusted figures for retirements on disability pension (see Figure 5).²⁴

²² Hytti (2001).

²³ Gould and Nyman (2002).

²⁴ Gould and Nyman (2004).

Figure 5. Age-adjusted new earnings-related pensions for persons aged 55–64 years in 1996–2004. *Source:* Pension Statistics, Finnish Centre for Pensions.

Part-time pension is the third form of early retirement, which has been popular in the last few years, although it differs from the other forms in that employment continues on a part-time basis. The conditions for part-time pension have been reformed on several occasions during its existence. The reasons for the reforms have been linked with steering the provision of the labour force; at times there has been a need to decrease, at other times to increase the ageing labour force.²⁵ This trend is also visible in the changes affecting part-time pension.

A definite escalation in new part-time pensions took place in 1998, as the age limit was temporarily brought down from 58 to 56 years. Those eligible for part-time pension close to the lower age limit have been especially keen to take advantage of the right to part-time employment, which is a requirement of the part-time pension. Part-time retirement has also been more popular than before among those who have turned 60 years.

The number of new part-time pensions rose in 2002, a year before its conditions were reformed. Presumably, ageing employees suspected that the part-time pension system might not be preserved or its conditions might deteriorate radically. In 2003–2004, eligibility for part-time pension was not extended to new age groups, which can be seen from the slump in figures for part-time retirement (see Figure 5).

In addition to those schemes mentioned above, agriculture also has its own early retirement arrangements, although their significance has decreased in the last few

²⁵ Takala (1999).

years as a result of raising age limits and a decline in the population engaged in agriculture. In the last few years an average of two per cent of 60–62 year-olds have been on special pensions provided by the agricultural industry (farmers' farm-closure pension).

Some of those who have turned 60 years retire on old-age pension and effectively exit the labour market, even before they reach the general retirement age. One in four retired 60–64 year-olds was on old-age pension at the end of 2003. Persons in this group receive pension at a lowered age or have contributed personally towards earlier retirement.

Average age for retirement and for exiting working life

Work life expectancy

Although the main reason for exiting working life is retirement, in light of extending the working career it is necessary to pay attention to the retirement age as well as the age for exiting working life. Hytti and Nio²⁶ have adopted an indicator to calculate the age for exiting working life, which is based on the "lifecycle model".²⁷ The indicator makes it possible to separate the lifecycle approach to participation in working life from the approach to the ageing of the population, enabling the measurement of the independent impact of the two factors on the changes in the employment rate.

The lifecycle-based indicator takes into consideration the fact that working life is becoming increasingly flexible and work is redistributed throughout a person's entire lifecycle. Examples of this include the flexible age for old-age retirement, the growing needs for harmonizing work and family life and the principle of lifelong learning.

When they are calculated according to the lifecycle model, labour force participation expectancy and work life expectancy have experienced strong growth among 15 and 50 year-olds within the last decade. Compared with 1994, labour force participation expectancy for over-50 year-olds has risen by 1 year and the working life expectancy by 1.7 years. Both expectancies have already exceeded the levels before the recession of the 1990s. In 2003, life expectancy at 50 was 30.7 years, (men 28.0 and women 33.3 years), labour force participation expectancy was 9.3 years, (men 9.5 and women 9.1 years) and working life expectancy was 8.7 years, (men 8.8 and women 8.5 years).²⁸

Expected effective retirement age

The development of the retirement age can be illustrated by the expected effective retirement age, which is based on the retirement risk. In this way, the effective retirement age does not react to the changes in the age structure of the population, making it a practical indicator for the near future, as the baby-boom generation

²⁶ Hytti and Nio (2004).

²⁷ In more technical terms, the measure is based on the prevalence-based life table methods (Sullivan method).

²⁸ Hytti and Nio (2004).

Figure 6. Expected effective retirement age (i.e. expectancy) in 1983–2003. Persons retired from the private sector. *Source:* Pension Statistics, Finnish Centre for Pensions.

approaches retirement.²⁹ In Finland, the expectancy is calculated for those aged 25 and 50 years.

A distinct rise has occurred in the expected effective retirement age in the last 20 years (Figure 6). The expectancy was at its lowest in 1986, when a large number of the insured took early retirement. Since then, the expected effective retirement age has risen by almost three years. The expectancy for 50 year-olds is growing at a faster pace than that for 25 year-olds. The rise in the expectancy for 50 year-olds is largely explained by the fact that retirement for over-60-year-olds is taking place later. In 2004, the expected effective retirement age was 61.1 years for 50 year-olds. A pronounced difference does not exist between women and men (women 61.0 years and men 61.1 years).³⁰

Motivations for the policy change

It was only in the 1980s that a fairly broad consensus was reached on the desirability of the early exit culture. According to that view, social goals for the ageing workforce were combined with the targets for promoting the competitiveness of the open sector of the economy.³¹ Ageing employees were given the opportunity to leave the labour market altogether, and they were replaced by better trained, younger workers in new, more productive jobs. The role of early retirement policies was strengthened by the relatively large disparity in educational level according to age. This implied, among

²⁹ For information on calculating retirement expectancy, see Kannisto (2004).

³⁰ Eläketurvakeskus (2005).

³¹ See Hytti (2002).

other things, that the temptation to use early retirement as a means for restructuring was clear.

Finland witnessed a rapid change from an early exit culture to an active ageing policy. Reducing the right to early retirement is not an easy task for policy-makers, since retrenchment policies have dramatically different electoral implications from the expansionary efforts of the past.³² Thus, it is relevant to ask what made it possible to introduce reforms aimed at increasing rather than decreasing the labour supply in a very weak labour market situation in the 1990s. We present three possible explanations.

Need for fast-acting reform

The objective need for fast-acting reforms is one explanatory factor behind the reforms in the early exit schemes and good employment performance. This is related to the question of the ageing of the population and the timing of this demographic change. In Finland, the baby-boom took place earlier than in central European countries, which means that the peak in “demographic stress” will also take place earlier.³³ When the large baby-boom generation starts to reach the age for which early retirement channels are available, early exit from the labour market will become an increasing problem. This will actually happen very soon, within the next 5 years. At the same time, younger age groups entering the labour market are smaller and need not only to satisfy the demand for labour in expanding sectors, but also to replace the increasing numbers of workers who retire. This concern for potential imbalances in the labour market has made it necessary to find new solutions for the labour market and pension policy.

The need for reforms was also strengthened by the recession of the early 1990s, since it created a reduction in employment that became rather permanent. The recession showed that the public sector in Finland was built on high employment in addition to relatively firm economic growth. The recession drove public finances rapidly into a steep deficit, while the sharp fall in the employment rate weakened the financial base of the public sector. Consequently, the long-term sustainability of public sector finances had to be re-evaluated and new measures were needed to bring public sector finances into balance. The need was further strengthened as the new population forecasts of the late 1990s demonstrated that life expectancy is likely to increase in the future more than was previously assumed.

Crisis awareness as an enabling factor

The objective need for reforms is not enough in itself, but a capacity for designing acceptable reforms and sufficient political will are required for Parliament to pass the necessary new bills. The severe economic recession also brought an awareness of the crisis, helping us to understand why it has been possible to pursue tight fiscal policy, negotiate moderate wage increases and carry out structural reforms, even if they have been piecemeal rather than radical.

³² Ney (2003).

³³ See for example Börsch-Supan (2005).

The recession led to serious imbalances in public finances and a need for cuts in public expenditure. It has been estimated that about a hundred important cuts in social policy and social benefits were made.³⁴ This led to the conclusion (at least among the political elite) that the welfare state could not continue to grow. One societal consequence of the recession was the fact that during the post-recession period, social policy was increasingly evaluated on the basis of its effects on economic efficiency and incentives.³⁵ This was a clear change, since during earlier decades the emphasis was on its effects on income distribution. In the post-recession period, the emphasis was on the negative effects of social policy on work incentives and labour supply. It is likely that this general trend was one contributing factor that made the social partners increasingly willing to negotiate and agree upon the necessary reforms in the labour market and in social policy.

The schemes must be reformed according to changing conditions

The early exit policies were introduced when the labour market situation was very different from that of the 1990s. Initially they worked rather well, but mass unemployment changed the situation in many respects. When the need to cut the workforce became reality, new problems emerged. The risk of unemployment increased disproportionately for ageing workers with early exit options, and re-employment stayed almost non-existent among ageing unemployed persons.

Accordingly, it can be argued that the safety net started to have side effects that worked against the interests of employees. Increasing awareness of these problems influenced the realization among the social partners and the policy-makers of the need for a reform policy. Policies needed to be adjusted to the changing conditions in the economy and the labour market.

Will the pension reform increase labour supply?

The future challenges for the Finnish pension system are connected at least with the sustainability of the next era of population ageing. The rapid ageing of the population is one motivating factor for a far-reaching pension reform that has recently been legislated in Finland. The latest reform introduces a new technique, the 'life expectancy coefficient', to bolster the sustainability of the pension scheme against demographic uncertainties.³⁶

The goal of the pension reform of 2005 is to postpone the retirement age by two to three years. In order to achieve the target, opportunities for early retirement have been reduced and financial incentives adopted for carrying on in working life. The role of individual decision-making (or optimization) is increased: the reform includes an opportunity for retirement between 63 and 68 years and an early-retirement option at

³⁴ Lehtonen et al. (2001).

³⁵ Kiander (2001).

³⁶ See for example Börsch-Supan (2005).

Figure 7. The development of the employment rate in 1989–2003 for persons born in 1937 and 1945 employed in the private sector. *Source:* Tuominen (2004).

62 years. Furthermore, there is a sharp increase in the accrual rate at the age of 63 years (from 1.9 to 4.5 per cent). Actuarial reduction takes place, if retirement happens at the age of 62 years.

Employees approaching retirement age and employers have provided their views in surveys on the impact of the reform on continuing in employment and postponing retirement. The results indicate that Finnish employees are likely to postpone retirement to some extent in the future, but are not keen to delay it very far. Most employees would like to retire on old-age pension at 63 years, or by 65 years at the latest.³⁷

The results of the survey of employees make it possible to evaluate what the intended retirement would signify in reality for two cohorts (see Figure 7). The recession of the early-1990s is the most important variable for the difference in the employment rates of the two cohorts. The younger cohort has remained employed at a far higher rate after the age of 55 years, while the recession had an adverse effect on the employment of the older cohort.³⁸

According to the survey, employers have a positive attitude towards the new old-age-pension scheme. In their view, the flexible retirement age makes it possible for the individual situation of each employee to be considered more effectively than at present. Employers believe more readily than employees that financial incentives are effective tools for extending working life.³⁹

However, both employees and employers feel that salary increases and other rewards are fairly insignificant in comparison with many other factors relating to the working community. According to the findings of the survey, the most important

³⁷ Tuominen and Pelkonen (2004).

³⁸ Tuominen (2004).

³⁹ Tuominen *et al.* (2004).

Figure 8. The share (%) of establishments and oldest employees in the private sector, who consider the following measures as very important in order to continue in employment. *Source:* Tuominen *et al.* (2004).

factors for continuing in employment included a good atmosphere within the working community, a good and functional working environment and good management (see Figure 8). The views of employers and employees were largely consistent; training for promoting professional skills is the only area which employers view as clearly more important than employees do.

The impacts of the pension reform on retirement age and on the provision of the labour force will thus be in line with what has been intended. According to Lassila and Valkonen,⁴⁰ it is difficult to estimate whether the pension reform will affect a rise in employment rates, but reducing early pensions and raising age limits will postpone the retirement age. The attitudes of employers and employees also suggest willingness to extend one's working career.

Final remarks

The crucial element behind low employment levels among ageing workers is the existence of the various early retirement schemes and rules that govern eligibility for those schemes. Countries with a pension system consisting of several early retirement schemes are likely to face more difficult challenges in trying to increase the employment level of ageing workers. The existing early retirement channels

⁴⁰ Lassila and Valkonen (2005).

are likely to maintain the expectations of a short working career also among the young cohorts. Additionally, the reforms carried out may turn out to be inefficient. For example, a partial reform may only move persons from one early retirement scheme to another with no overall effect on labour force participation of ageing workers. Furthermore, the existence of the early retirement channels may undermine the reforms that aim to increase the work incentives of the normal or standard old-age-pension schemes.

In Finland, a remarkable change has taken place in early exit policies in the last fifteen years. The new system is a stripped-down version of the one that existed in the early-1990s. This is likely to give Finland an advantage in further increasing the employment of older workers.

However, the weak re-employment prospects of the ageing unemployed persons is still a problem. The design of the schemes should thus place increasing significance on re-employment possibilities. This need is strengthened by the fact that companies have to face increased international competition, making them much more vulnerable to shocks from outside the national economy. At the same time, the relocation of operations and production has become easier, and this also strongly affects labour markets. It is likely that these conditions mean that jobs are lost and also created at a rapid pace. Ageing workers losing their jobs require increased possibilities to return to the labour market.

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Appendix

Old-age, disability, unemployment and early retirement pensions in Finland

<i>Pension type</i>	<i>Pension system</i>	<i>Lower age limit</i>	<i>Year</i>	<i>Award criteria</i>
Ordinary disability pension	EP	16	1962	Reduced capacity for work
Disability pensions, 60 +		60	2005	Lower severity of illness, long career
Individual early-retirement pension	EPPriv	55	1986	Lower severity of illness, long career
	EPPubl	55	1989	
	EP	58	1994	
		60	2000	
			2005	Abolished
Unemployment pension	EP	60	1971	Long-term unemployment
		58	1978	
		55	1980	
		60	1986	
			2005	Abolished
<i>Old-age pensions</i>				
Early old-age pension	EPPriv	60	1986	Permanently reduced benefit
	EPPubl	58	1989	Permanently reduced benefit
	EP	62	2005	Permanently reduced benefit
Ordinary old-age pension	EPPriv	65	1962	
	EPPubl	63		
		65	1993	
	EP	63	2005	
		(−68)		
Part-time pension	EPPriv	60	1987	Limits on working hours and earnings
		58	1994	
	EPPubl	58	1989	
	EP	56	1998	
	EP	58	2003	

Note: EP=employment pension insurance in general; EPPriv=private-sector employment pension insurance; EPPubl=public-sector employment pension insurance.