Professor Axel Börsch-Supan:

”The 2005 Pension Reform in Finland”

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General remarks

- profound and insightful analysis
- appraisal from an international viewpoint very useful
- essential features of both the new and the old system well perceived

My comments

- less a sign of disagreement
- rather suggestions that arise from an alternative starting point at some issues

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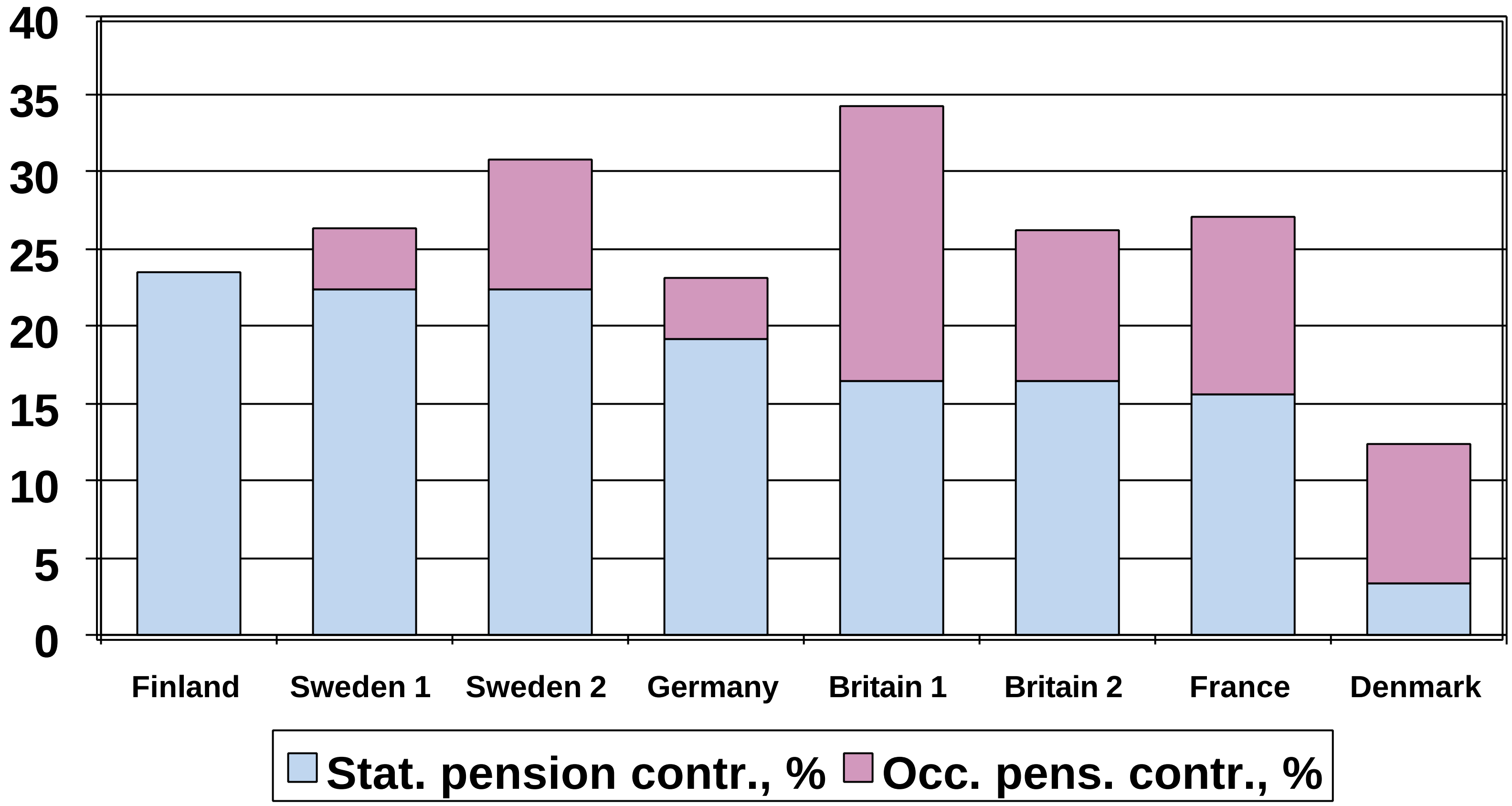
International comparisons

- two-thirds target level for earnings-related pensions almost a natural law
- figures for TEL should be compared to a combination of Pillar I and Pillar II pensions in other countries
- then the present and future contribution level are seen in another light
- of course, other countries also fight against rise in the pension contributions

Statutory contributions and occupational pension contributions in proportion to average salary in 2002



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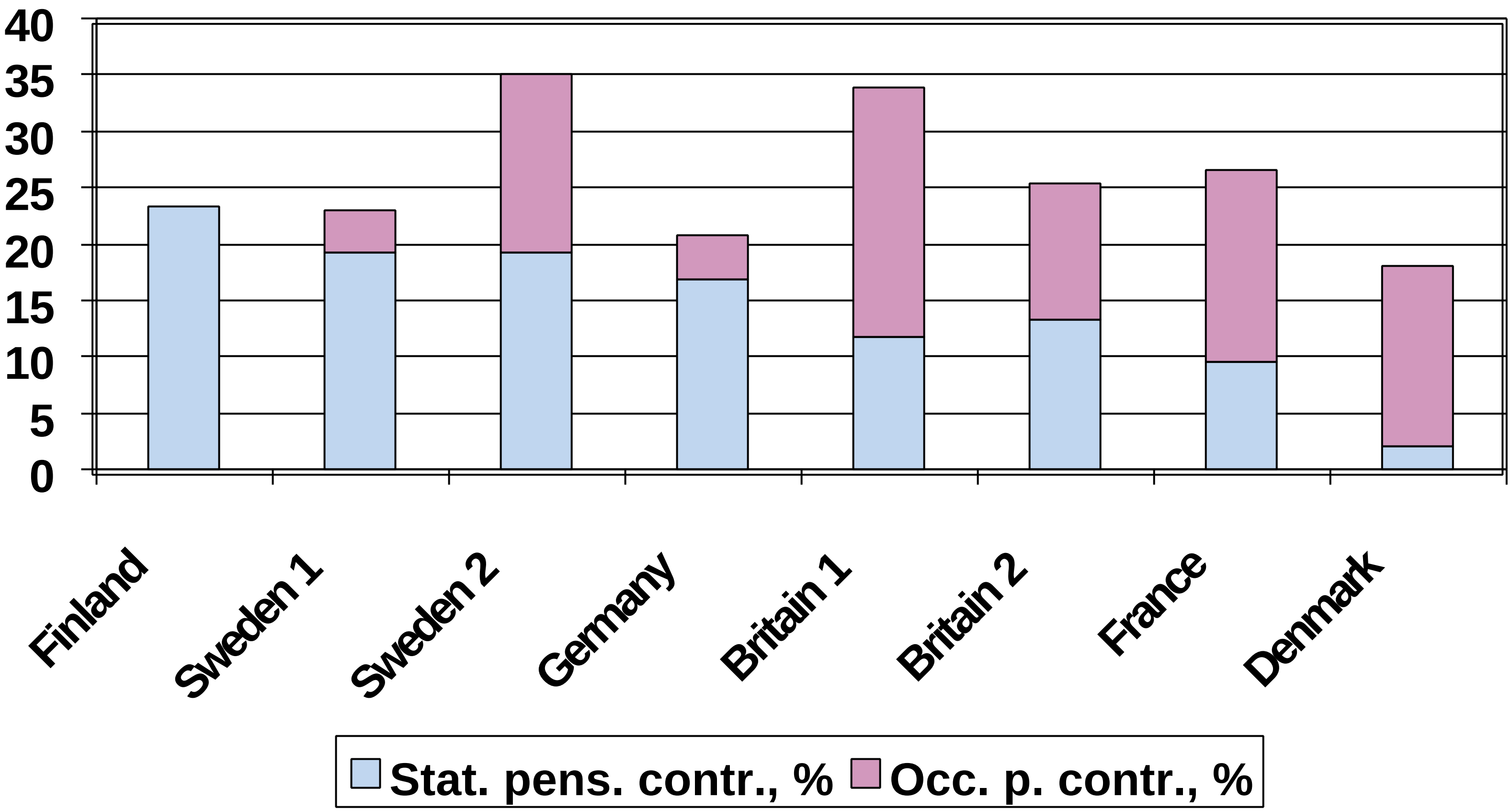
Source: The Finnish Centre for Pensions

Statutory contributions and occupational pension contributions in proportion to a salary 2 x average salary in 2002



Source: The Finnish Centre for Pensions

Yardstick for a good pension system

- the list of six criteria useful
- the listed criteria as such are all important
- the existence of explicit criteria brings discipline into the discussion
- without systematic approach the discussion will never converge

Risk analysis as the starting point

- another starting point: risk analysis
- pensions are about risk
- earnings-related pensions safeguard against risks related to earnings from work
- however, no pension system can be risk-free
- hence, a suggestion for an algorithm for judging alternative pension designs :

Step 1: For each pension system design, chart all risks and check by whom they are borne

Step 2: Choose: is this what we want?

Merit in this approach:

- Step 1 can be done objectively
- disagreement has its place during Step 2

Move part of the Finnish earnings-related pensions to a voluntary regime?

- coverage under voluntary systems never even nearly complete
- in Finland those without earnings are catered for by the national pension
- those with top earnings have a good negotiating position with the employer
- or sufficient means to take care of themselves
- the large majority would face the risk of insufficient pensions: short-sightedness, other more pressing demands
- the adequacy goal not reached!
- weight this against the risk for the national economy caused by high contributions

- reduce detrimental effects by reinforcing the link between benefits and contributions
- our reform a step into this direction
- agreed: confused by different accrual levels and transition rules

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Unit linked earnings-related pensions?

- great volatility inherent in the process of investing money
- accordingly, big differences in pension levels unavoidable in systems with individual investment decisions
- consequence: people face the risk of an insufficient earnings-related pension
- the adequacy goal again at risk!
- risk is certain to materialize for a considerable portion of people
- a number will succeed very well
- such differences hardly justified when pensions are considered

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Strong disagreement with the statement that “it is a major weakness of the system that it is one big system without any private savings character”

The long list of problems in non-public alternatives:

- high administrative costs
- misuse by the employer
- mis-selling to inexperienced workers
- lack of financial expertise

Worst drawback from the risk point-of-view is the quality of the final product:

- the pension may prove inadequate, and the system is not equitable

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Setting a limit to the contribution level

- target voiced by the Finnish employer organizations
- OK if fulfilled by a general success in postponing retirement
- not OK if achieved by reducing the level of the statutory system

What would happen?

- the employer fills the gap by a voluntary arrangement, thus no reduction in employment costs
- employees themselves buy voluntary insurance: effectively a reduction in wage level
- or employees get inadequate earnings-related pensions

Reduction in employment costs means reducing the well-being of employees either directly or indirectly

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Equation:

"a contribution rate of clearly above 20% in a statutory system is too high"

translates into

"some people must be left outside proper occupational pension cover"

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The benefits of the baby-boomers

Agreed: many transition rules reduce the intended elegance of the new system

The choice was

- not between a system with transition rules and a system without them
- but between a system with transition rules and no reform at all.

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Why the 4.5% accrual rate?

To make it absolutely clear that continuing at work improves the pension.

- separate accrual and actuarial adjustment was considered too complicated
- people will also get yearly calculations: what do you get if you work until 63/65/68

Why the 1.9% accrual rate?

- The white-collar workers did not like pure career average rule
- The 1.9% between 53 and 63 lends some flavour of a final salary rule

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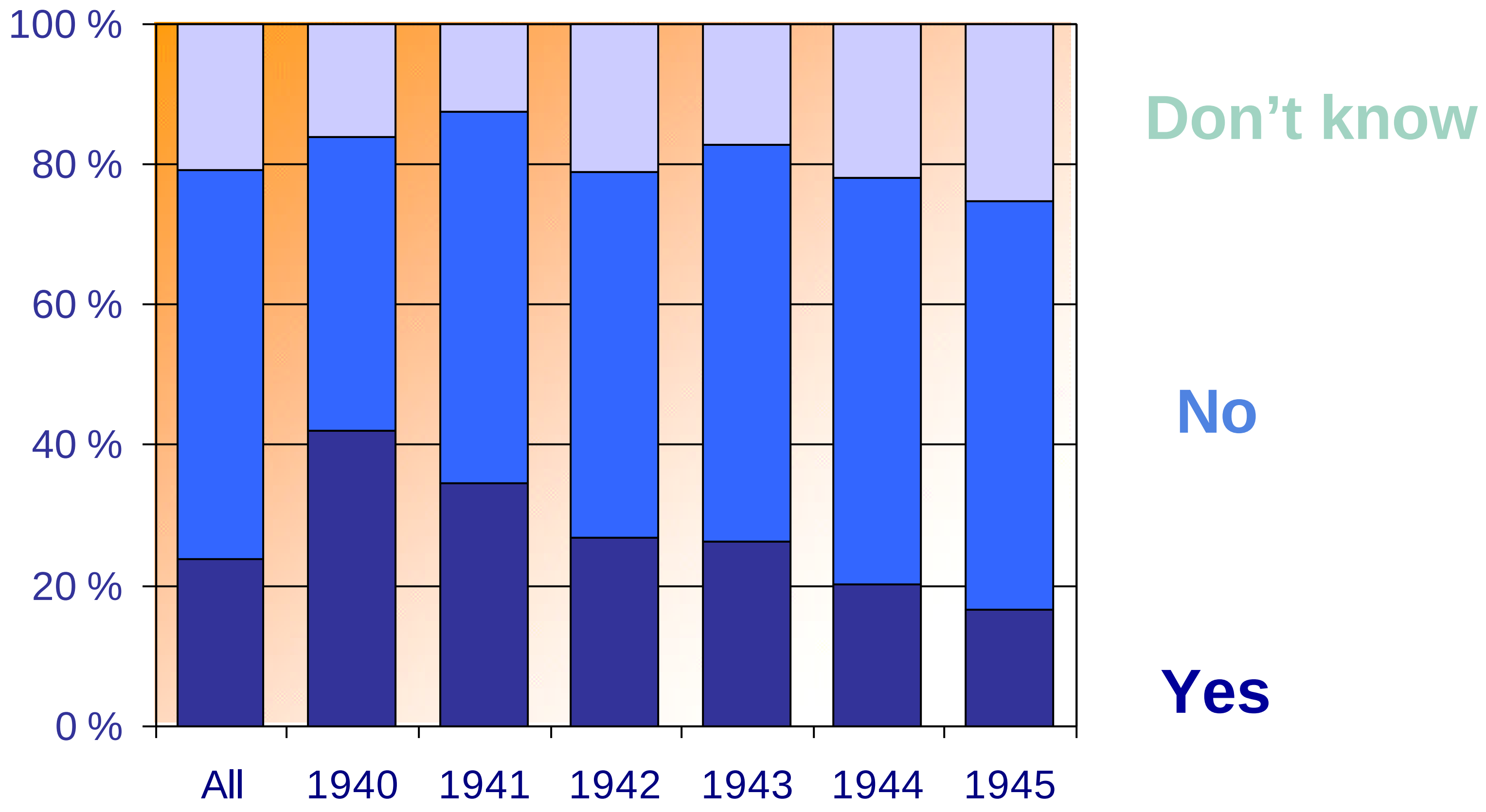
Does the annual accrual rate of 4.5% increase the willingness to continue working beyond the age of 63 ?



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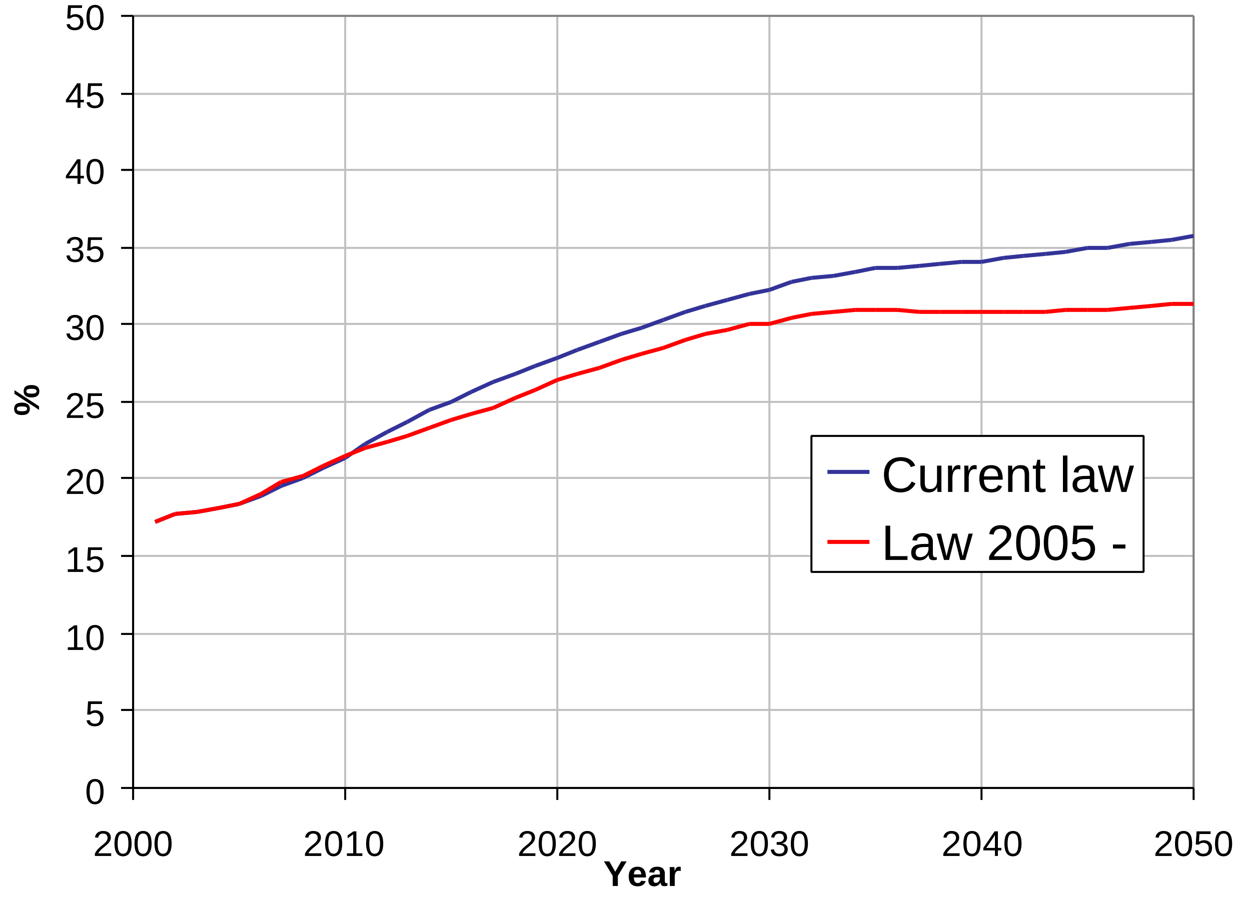
Source: Tuominen & Pelkonen 2004

Funding

- additional 7.5% fund will be drawn down
- no agreement yet about the main fund
- if drawn down, the contribution level will jump to the PAYG level
- catastrophic consequences
- funding rate should be adjusted to produce a reasonable development of contributions
- the projected rise in the contribution rate is not a consequence of transition rules only

Pension expenditure as a % of wages in 2005-2050 (private sector employees)



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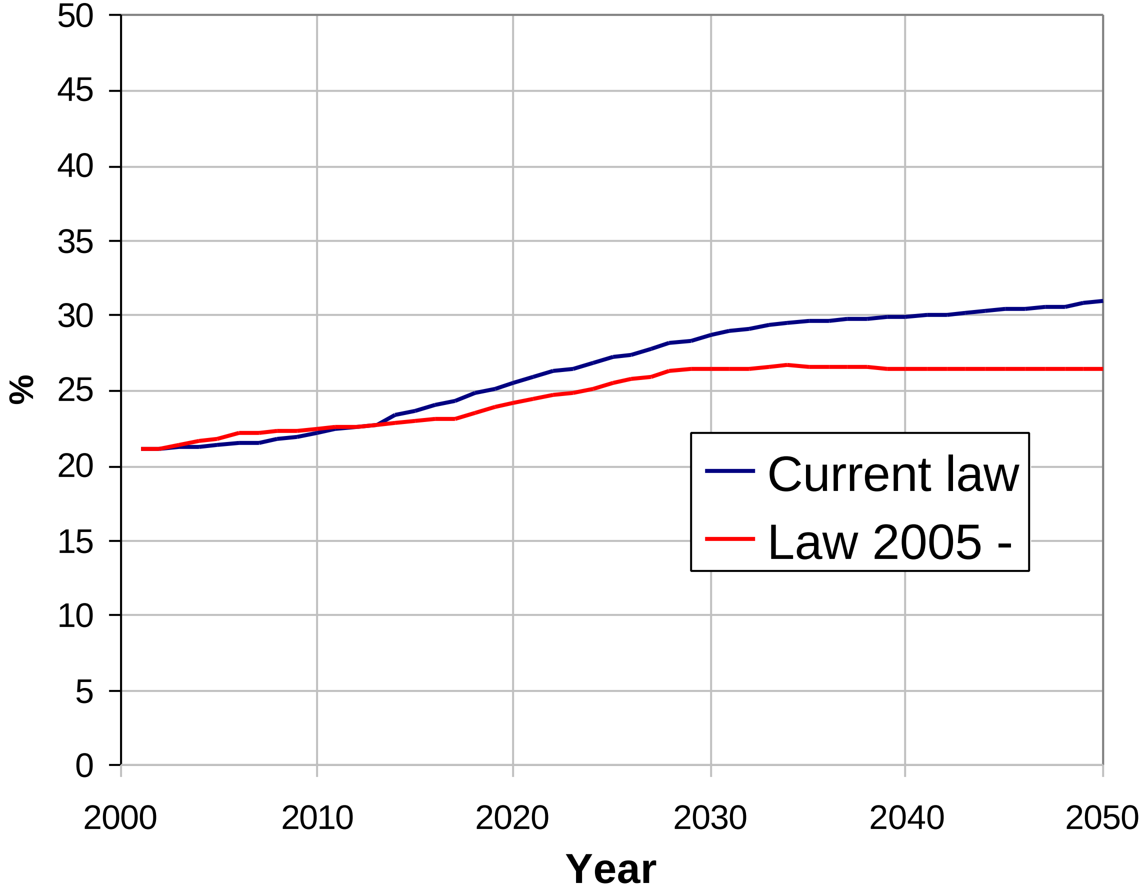
Source: The Finnish Centre for Pensions

Private sector pension contribution as a % of wages in 2000-2050



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Source: The Finnish Centre for Pensions

The future?

- the 2005 reform an interim step? perhaps
- depends on the future behaviour of the workers
- strong tradition that changes are negotiated between the social partners
- a simpler and more actuarial formula may well be in place after some time
- advantages of a privatized individual approach?
- seems to depend on the viewpoint
- from the risk viewpoint, they are simply not there

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