

Aging population and the prospects of the Finnish economy

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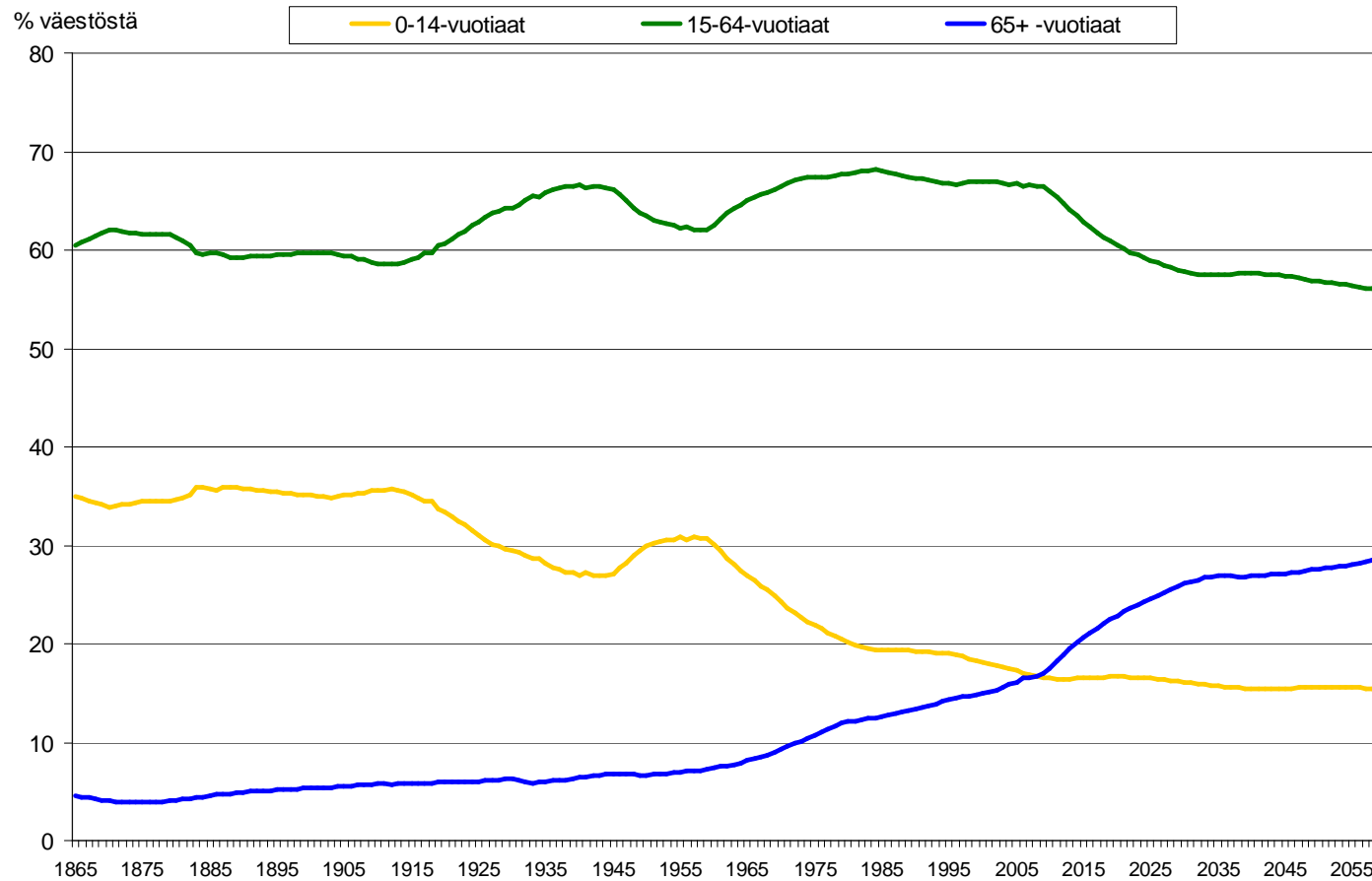
Aging population and the prospects of the Finnish economy

- Expected population changes
- Economic consequences of aging population
- How Finland is prepared to aging?
- What needs to be done/Policy questions
- Prospects for the coming decades
- Concluding remarks

Expected population changes

- Contributing factors:
 - Increasing longevity
 - A non-change: Stable fertility
 - Retiring baby boomers
 - Immigration
- Results:
 - Numbers of children and working-age population are going to remain unchanged (unless immigration increases)
 - Numbers of pensioners and very old people are going to increase steeply

Population aging to be expected in 2010-2030



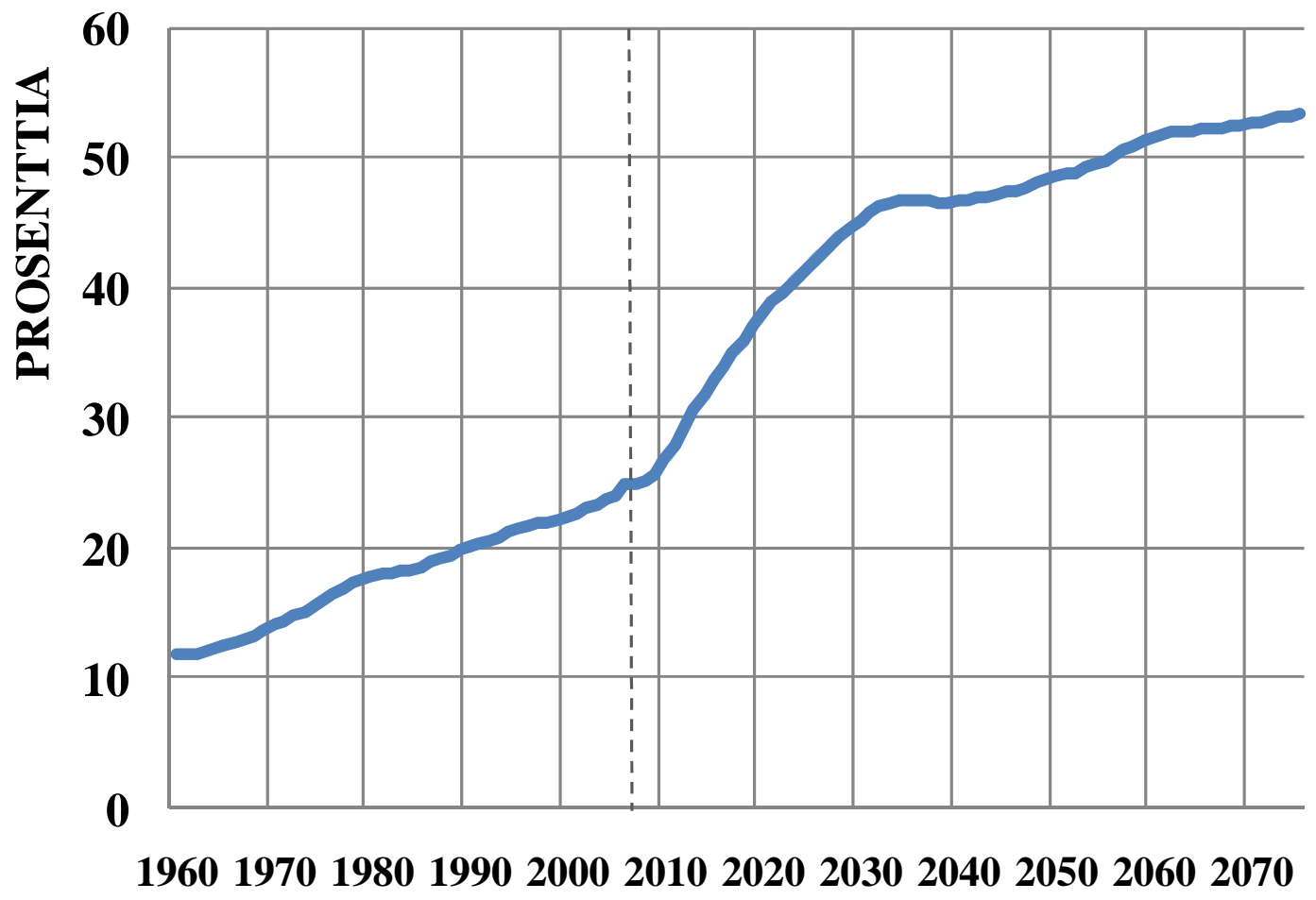
How does Finland differ from other countries?

- Aging is going on in most countries in the 21st century
- In Finland major aging happens earlier than elsewhere: 2010-2030
 - The baby boom impact
- In the long run the Finnish age structure will be healthier than elsewhere: after 2050
 - Fertility is close to sustainable level

Economic consequences of aging population

- Dependency ratio:
 - from 25 % to 45 % in two decades
- Labour supply:
 - Working-age population is going to decrease, but not very much
 - Labour supply can be maintained if participation rate increases
- Impacts on public finance:
 - Pension expenditure goes up
 - Demand for health care and social services expected to increase

Dependency ratio 1960-2075



**65 täyttäneiden suhde 15-64 -vuotiaisiin*

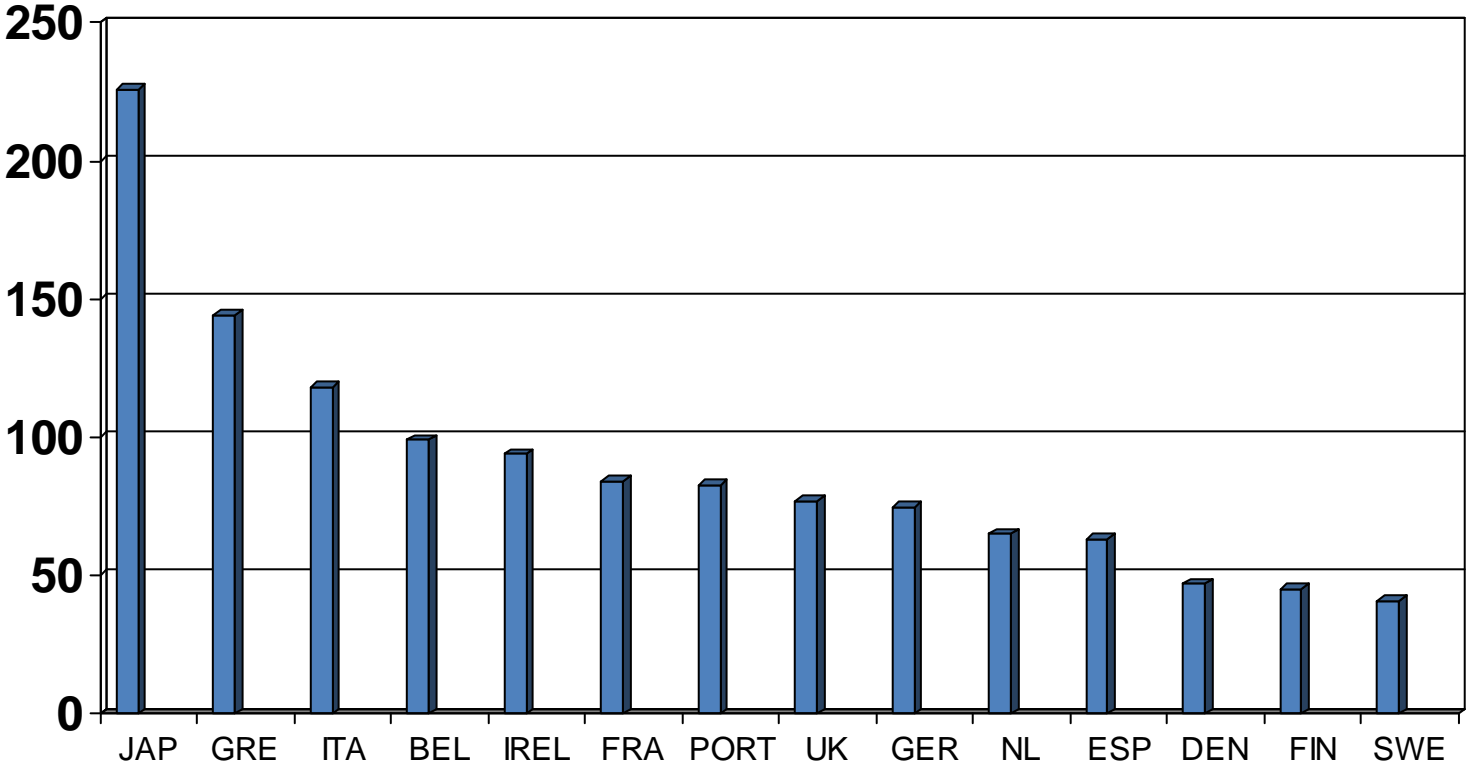
Fiscal burden

- Health care and social services to aging population
 - Projected spending increases 3-4 percent of GDP
 - Financed by general taxation
- Pension expenditure
 - Projected increase 3-4 percent of GDP
 - Will be partly covered by pension funds
- Pressure on tax rate
 - From 42 to 47 percent of GDP?
- Legacy of the Great Recession of 2009

How Finland is prepared to aging?

- Labour market
 - Rather flexible
 - ... but large underemployment (open & hidden U)
 - Better than EU average but not as good as in other Nordic countries
 - Employment rate close to 70 percent -> potential for better outcomes
- Central and local government
 - Traditionally fiscally conservative, low debt, lots of assets (=AAA)
 - Problem: large cyclical changes in central government fiscal balance
- Pension system
 - Quasi-public, compulsory, earnings-related, actuarially fair
 - Defined-benefit, partly funded (total funds 70 percent of GDP), partly pay-as-you-go

Public debt in selected countries in 2010



Pension reforms 1/2

- Major reform in 2005: sticks and carrots
 - From fixed (65 y) to flexible (63-68) retirement age
 - Objective was to increase the average retirement age from 59 to 62 years
 - Carrots: higher benefits for those working post 63
 - Sticks: longevity coefficient to reduce cohort-wise future pensions if mortality goes down
- Results
 - By 2010 the average retirement age was increased to 60,4 years

Pension reforms 2/2

- Higher funding decided in 2010
 - Gradual rise in pension contributions in 2011-2014 to 23½ %
- What follows?
 - Negotiations going on how to extend work careers and improve funding after 2014
 - Focus on disability and working life

What needs to be done/Policy questions

- Fiscal policy and public service provision
 - Rebalancing of central government finances after the financial crisis
 - Reforming the local government sector and its service provision
- Measures to increase labour supply
 - Incentives and capabilities to extend work careers should be improved
 - Young, old, disabled, long-term unemployed,...
- Pension system and retirement incentives need further reforms

Prospects for the coming decades

- Rapid change in dependency ratio
 - Big change, but Finland is not totally unprepared
 - Higher participation and employment rates will help to adjust
 - How will immigration develop?
- Pressure on public finances
 - Gradual rise in taxation
 - Pension contributions, local government income taxes, indirect taxes...
 - Continued squeeze on public spending

Prospects ...

- Better outlook for the long term
 - Dependency ratio is going to stabilize in mid-century
 - After that, population structure will be better than in most European countries
 - With strong public finances Finland is (relatively) well-prepared to face the rapid aging

Concluding remarks

- Challenges
 - Aging is a major challenge but it looks manageable
- So far, better than expected
 - Until now development in economy and population have been better than expected
- Big questions remain unanswered:
 - What will happen to the future longevity trends?
 - Will immigration increase as a response to labour shortage?