

Finland

The two-tier pension system consists of a basic national pension, which is income-tested, and a range of statutory earnings-related schemes, with very similar rules for different groups. The modelling covers the scheme for private sector employees (TEL). The schemes for private-sector employees are partially pre-funded while the public-sector schemes are pay-as-you-go financed (with buffer funds to even out future increases in pension contributions). Major pension reform was introduced in Finland in 2005. The rules presented here refer to long-term situation when all reforms are fully phased-in.

Qualifying conditions

The national pension is subject to a residency test and withdrawn against pension income from the earnings-related schemes. The national old-age pension is payable from age 65. The full national pension benefit is payable with 40 years residence as an adult, with *pro-rata* adjustments for shorter periods of residence. Early retirement on the age national pension is possible from age 62.

In the earnings-related pension scheme, the retirement age is flexible between 63 and 68 (from 2005). In addition, early retirement is possible at age 62 and the pension can be deferred beyond age 68.

Benefit calculation

Earnings-related

From 2005, the accrual rate is 1.5% of pensionable earnings at ages 18-52, 1.9% at ages 53-62 and 4.5% at ages 63-67. For a full-career worker working from age 20 until retirement at age 65, the total lifetime accrual will be 77.5% of pensionable earnings. The earnings measure is based on lifetime average earnings. In the calculation, however, the employee's pension contribution is deducted. Note, however, that the replacement rates are shown relative to total gross earnings.

Earlier years' earnings are re-valued in line with a mix of economy-wide earnings and prices. From 2005, wage growth has an 80% weight and price inflation, 20%. After retirement, the earnings-related pension is uprated using a formula of 20% of earnings inflation and 80% of price inflation.

From 2010, newly awarded benefits will be reduced according to increases in life expectancy. The calculations use lagged mortality data: for 2010, for example, the data are the average for 2004-2008 compared to the base year which in turn results from data for 2003-07. Between 2002 and 2040, the UN/World Bank mortality projections imply an increase in life expectancy at age 65 from 16.8 years to 20.4 (calculated from unisex mortality rates). The adjustment takes the form of an annuity calculation using a discount rate of 2% per year. The adjustment is expected to reduce benefits to 88.6% of their value under the pre-reform rules by 2040. The life expectancy coefficient is calculated for each cohort at the age of 62.

There is no contribution floor and no ceiling to contributions or pensionable earnings. However, there are minimum earnings limit for pension insurance.

Minimum

The parameters of the national pension scheme differ between municipalities. The full basic monthly benefit for a single pensioner in 2004 was EUR 496.38 in the first

municipality group and EUR 475.73 in the second municipality group, corresponding to just below a fifth of average earnings. The national pension is reduced by 50% of the difference between other pension income and a small disregard which in 2004 was EUR 559 per year. No pension is payable once other pension income exceeds EUR 1 016.96 or EUR 975.58 per month, depending on municipality group. Note that the modelling uses the higher value for the national pension.

From 2005 on, earnings-related pension rights accrued after the age of 63 will be disregarded when national pension entitlement is calculated.

The basic pension benefit, the parameters of the means test, and pensions in payment are uprated annually in line with prices. In practice there have been additional increases based on separate decisions. Note that the modelling assumes uprating with earnings over the long term.

Early retirement

Early retirement is possible in the national pension scheme from age 62. From 2005, the pension is permanently reduced by 0.4% for each month of retirement before the age of 65.

Early retirement is also possible at age 62 under the earnings-related scheme, subject to a 0.6% benefit reduction per month of early retirement until the age of 63. After the age of 63 there is no benefit reduction.

Late retirement

From 2004 the national pension can be deferred after the age of 65 and the pension is then increased by 0.6% for each month by which retirement is postponed.

From 2005 onwards, the increment for late retirement is reduced to 0.4% for each month (4.8% per year) in the earnings-related scheme after age 68. There is no adjustment between ages 63 and 68 because of the accelerated accrual of pension at those ages.

It is possible to combine receipt of pension and earnings from work. From 2005, after taking the old-age pension, earnings accrue additional pension right with a rate of 1.5% per year until the age of 68.

Pre-reform scenario

There have been several changes in the rules of different pension schemes since 1990 and the model uses 1990 rules as follows.

The normal pension age was 65. The early pension eligibility age was 60.

Before reform, there was a basic element to the national pension that was not resource-tested. In 1990, this amounted to FIM 390 per month.

The additional, pension-income-tested benefit was FIM 1 824 per month for a single person. (Again, this varied by municipality: this is the figure for Helsinki.)

To derive parameters that would have applied in 1994 had the system not been reformed, the ratio of the basic to the national pension that applied in 1990 is used to calculate basic and pension-income-tested pension levels for 1994. These are EUR 1 054 and EUR 4 907 respectively.

The earnings-related scheme had a linear accrual rate of 1.5% per year for each year of contributions in year 1990. The entry age for earnings-related pensions was 23, compared with 18 currently (i.e. no accrual before 23). There was no accrual from age 65.

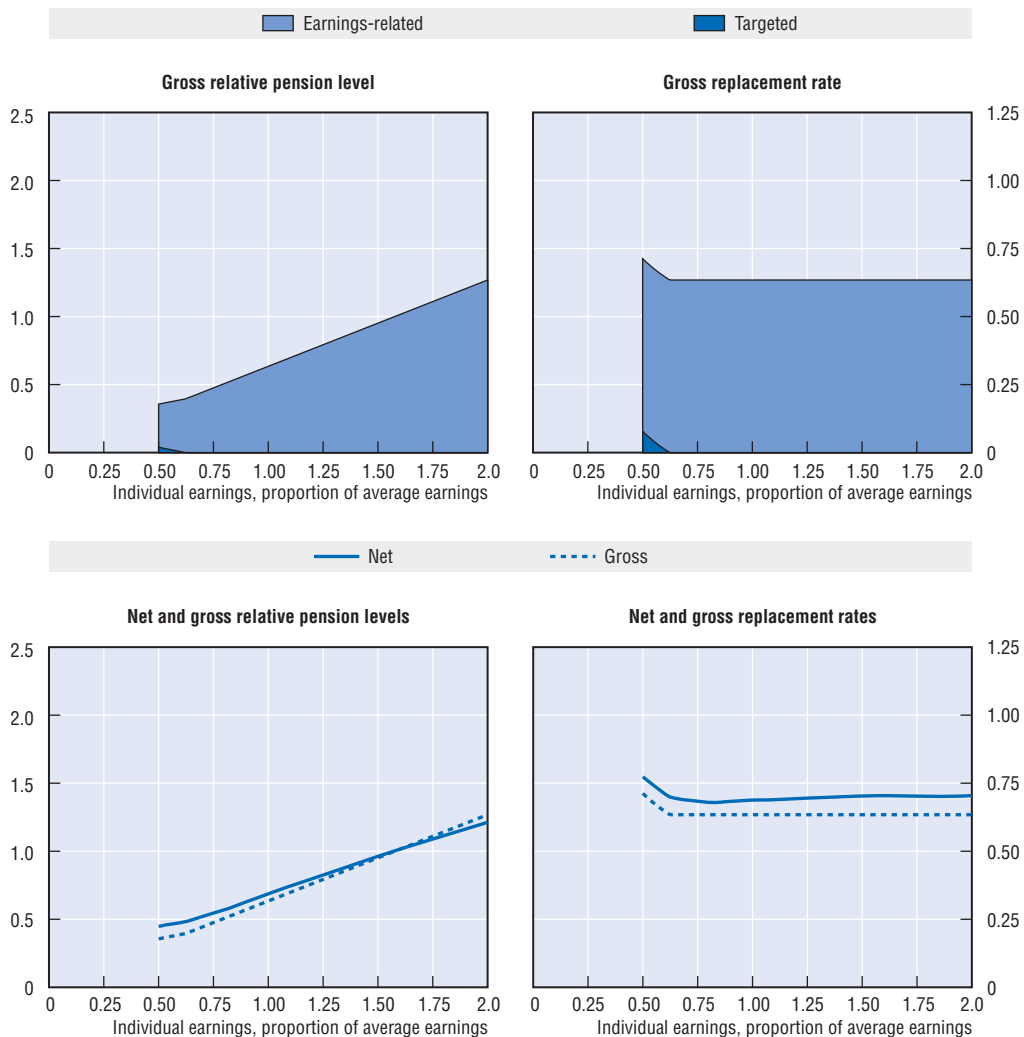
Indexation of pensions in payment and valorisation of earlier years' earnings were both 50:50 to earnings and prices. From 1996, pension indexation changed from the age of 65 to 20% earnings inflation and 80% price inflation. For past earnings and to pensions payable to those under 65, it remained at 50% earnings and 50% prices.

The earnings measure was based on the middle two of the final four years' earnings in each job (*i.e.*, excluding the highest and lowest earnings of the final four years). There was no employees' pension contribution until 1993. Pensionable earnings were gross earnings until 1996, when pensionable pay was redefined as earnings less employees' pension contributions (see above).

The reduction for early retirement under the pre-reform earnings-related scheme was between 0.37% and 0.5% per month (4.44%-6% per year) depending on the year of birth of the recipient. The national pension was reduced by 0.5% per month of early retirement.

Deferral of pensions earned an increment of 1% per month for both earnings-related scheme and basic/national pension.

Pension modelling results: Finland



Men	Median earner	Individual earnings, multiple of economy-wide average				
		0.5	0.75	1	1.5	2
Women (where different)						
Gross relative pension level (% average gross earnings)	53.9	35.6	47.6	63.4	95.1	126.9
Net relative pension level (% net average earnings)	59.8	44.8	54.5	68.8	96.2	121.2
Gross replacement rate (% individual gross earnings)	63.4	71.3	63.4	63.4	63.4	63.4
Net replacement rate (% individual net earnings)	68.0	77.4	68.4	68.8	70.3	70.5
Gross pension wealth (multiple of individual gross earnings)	10.0 11.8	11.2 13.2	10.0 11.8	10.0 11.8	10.0 11.8	10.0 11.8
Net pension wealth (multiple of individual gross earnings)	7.6 9.0	9.6 11.4	7.9 9.3	7.4 8.8	6.9 8.2	6.6 7.8

Pension modelling results: Finland, pre-reform scenario

Men	Median earner	Individual earnings, multiple of economy-wide average				
		0.5	0.75	1	1.5	2
Women (where different)						
Gross relative pension level (% average gross earnings)	56.9	35.5	50.6	66.3	97.8	129.3
Net relative pension level (% net average earnings)	62.3	44.6	56.5	71.0	98.0	122.4
Gross replacement rate (% individual gross earnings)	66.9	71.1	67.5	66.3	65.2	64.7
Net replacement rate (% individual net earnings)	70.9	77.0	70.9	71.0	71.6	71.1
Gross pension wealth (multiple of individual gross earnings)	11.1 13.3	11.7 14.0	11.2 13.4	11.0 13.2	10.8 13.0	10.8 12.9
Net pension wealth (multiple of individual gross earnings)	8.4 10.0	10.1 12.1	8.6 10.3	8.1 9.7	7.5 8.9	7.0 8.4

Foreword

This report provides indicators for comparing pension policies across OECD countries. It gives estimates of the level of pension people will receive if they work for a full career and if today's pension rules stay unchanged.

Monika Queisser and Edward Whitehouse of the Social Policy Division of the OECD's Directorate for Employment, Labour and Social Affairs prepared the report. Rie Fujisawa and Edward Whitehouse were responsible for the pension modelling and the analysis of the tax position of pensioners. Anna Cristina D'Addio and Jongkyun Choi assisted in finalising the report.

National officials provided invaluable, active assistance in collecting information on their countries' pension and tax systems. The results have been confirmed by national authorities with the exception of those for Italy, which are based on the OECD's interpretation of parameters and rules provided by the government.*

Numerous OECD colleagues provided guidance and information, particularly Mark Pearson, Martine Durand and John Martin. The OECD private-pensions team in the Directorate of Financial and Enterprise Affairs – particularly Fiona Stewart and Juan Yermo – provided useful input to the special feature on private pensions. Delegates to the OECD Working Party on Social Policy advised on modelling procedures and development of indicators for cross-country comparisons of pension systems. They also gave constructive comments on earlier drafts.

The report is the product of a joint project co-financed by the European Commission and the OECD; the project also benefited from a financial contribution made by the government of Switzerland.

The OECD pension models use the APEX (Analysis of Pension Entitlements across Countries) infrastructure originally developed by Axia Economics, with the help of funding from the OECD and the World Bank.

* Italy has expressed serious doubts about the adequacy of data used in the report, and consequently about the comparability of results. In particular, baseline assumptions about labour market entry ages and career length (respectively, 20 and 45 years) are different from those agreed in a comparable exercise undertaken at the EU level, and differ from current Italian labour market norms. Italy thinks interpretations based on these data may be misleading.

Structure of the Report and Methodology

The general approach of *Pensions at a Glance* is a “microeconomic” one, looking at prospective individual entitlements under all 30 of OECD member countries’ pension regimes. This method is designed to complement alternative comparisons of retirement-income systems: long-term fiscal and financial projections (for example, Dang *et al.*, 2001; and European Union, 2006) and analysis of income-distribution data (such as Förster and Mira d’Ercole, 2005; and Disney and Whitehouse, 2001).

The report is divided into three main parts. Part I presents the information needed to compare pension policies in a clear, “at a glance” style. It starts by showing the different schemes that together make up national retirement-income provision. Next, there is a summary of the parameters and rules of pension systems.

This is followed by eight main indicators that are calculated using the OECD pension models.

- The first two are the most familiar to pension analysts. Both are replacement rates, *i.e.*, the ratio of pension benefits to individual earnings. These are given in gross and net terms, taking account of taxes and contributions paid on earnings and on retirement incomes. Two analyses of the sensitivity of the gross replacement rate follow. The first looks at individuals who enter the pension system later than the baseline assumption, while the second considers the importance of investment returns in pension systems with defined-contribution (DC) components.
- The next two indicators are pension wealth, again given in gross and net terms. Pension wealth is a more comprehensive measure of pension entitlements than replacement rates because it takes account of pension ages, indexation of pensions to changes in wages or prices and life expectancy.
- Countries differ in the way that their pension systems aim to provide an old-age safety-net or replace a target share of pre-retirement income. The balance between these two is explored by the next pair of indicators: the first on the progressivity of the pension benefit formula and the second on the link between pension and earnings.
- The final two indicators aim to summarise the pension system as it affects individuals across the earnings distribution, showing the average pension level, pension wealth and the contribution of each component of the retirement-income system to overall benefits.

Two special chapters form Part II of this report. They cover pension reforms and private pensions, respectively. Both of these analyses use the OECD pension models to explore more deeply the central issues of pension policy in national debates. The framework of *Pensions at a Glance* is forward-looking, focusing on future pension entitlements of today’s

workers. However, the past decade has seen intense reform activity in the world of pensions and retirement. The first special chapter looks at what countries did and how this is likely to affect future benefits. A number of these reforms have increased the role of the private sector in pension provision. The second special chapter identifies the complex range of private retirement arrangements and quantifies the savings effort individuals will have to make to maintain standards of living in retirement.

Finally, Part III provides detailed background information on each of the 30 countries' retirement-income arrangements. These include pension eligibility ages and other qualifying conditions; the rules for calculating benefit entitlements; the treatment of early and late retirees; and more detailed information on the pre-reform scenarios explored in the special chapter on pension reforms. The country studies summarise the national results in standard charts and tables.

The remainder of this section describes the methodology used to calculate pension entitlements. It outlines the details of the structure, coverage and basic economic and financial assumptions underlying the calculation of future pension entitlements on a comparative basis.

Future entitlements under today's parameters and rules

The pension entitlements which are compared are those that are currently legislated in OECD countries. Changes in rules that have already been legislated, but are being phased-in gradually, are assumed to be fully in place from the start. Reforms that have been legislated since 2004 are included where sufficient information is available (in Portugal, for example). Some changes (such as the increase in pension age in Germany and the reform package in the United Kingdom) have not been finalised or were finalised too late for inclusion.

The values of all pension system parameters reflect the situation in the year 2004. The calculations show the pension entitlements of a worker who enters the system today and retires after a full career. The results are shown for a single person only.

Career length

A full career is defined here as entering the labour market at age 20 and working until the standard pension-eligibility age, which, of course, varies between countries. The implication is that the length of career varies with the statutory retirement age: 40 years for retirement at 60, 45 years for retirement at 65, etc. As the results can be sensitive to the career-length assumption, calculations are also made for situations where workers enter at age 25 and so retire with five years less than a full career.

Coverage

The pension models presented here include all *mandatory* pension schemes for private-sector workers, regardless of whether they are public (i.e. they involve payments from government or from social security institutions, as defined in the System of National Accounts) or private. For each country, the main national scheme for private-sector employees is modelled. Schemes for civil servants, public-sector workers and special professional groups are excluded.

Systems with near-universal coverage are also included provided they cover at least 90% of employees. This applies to schemes such as the occupational plans in Denmark, the Netherlands and in Sweden. An increasing number of OECD countries have broad coverage of voluntary, occupational pensions and these play an important role in providing retirement incomes. For these countries, a second set of results is shown with voluntary pension schemes in the special chapter on private pensions.

Resource-tested benefits for which retired people may be eligible are also modelled. These can be means-tested, where both assets and income are taken into account, purely income-tested or withdrawn only against pension income. The calculations assume that all entitled pensioners take up these benefits. Where there are broader means tests, taking account also of assets, the income test is taken as binding. It is assumed that the whole of income during retirement comes from the mandatory pension scheme (or from voluntary pension schemes in those countries where they are modelled).

Pension entitlements are compared for workers with earnings between 0.5 times and twice the economy-wide average. This range permits an analysis of future retirement benefits of both the poorest and richer workers.

Economic variables

The comparisons are based on a single set of economic assumptions for all 30 countries. In practice, the level of pensions will be affected by economic growth, wage growth and inflation, and these will vary across countries. A single set of assumptions, however, ensures that the comparisons of the different pension regimes are not affected by different economic conditions. In this way, differences across countries in pension levels reflect differences in pension systems and policies alone.

The baseline assumptions are:

- real earnings growth: 2% per year (given the assumption for price inflation, this implies nominal wage growth of 4.55%);
- individual earnings: assumed to grow in line with the economy-wide average. This means that the individual is assumed to remain at the same point in the earnings distribution, earning the same percentage of average earnings in every year of the working life;
- price inflation: 2.5% per year;
- real rate of return after administrative charges on funded, defined-contribution pensions: 3.5% per year;
- discount rate (for actuarial calculations): 2% per year (see Queisser and Whitehouse, 2006 for a discussion of the discount rate);
- mortality rates: the baseline modelling uses country-specific projections (made in 2002) from the United Nations/World Bank population database for the year 2040;
- earnings distribution: composite indicators use the OECD average earnings distribution (based on 18 countries), with country-specific data used where available.

Changes in these baseline assumptions will obviously affect the resulting pension entitlements. The indicators are therefore also shown for alternative assumptions regarding the rate of return on funded defined-contribution schemes. The impact of variations in economy-wide earnings growth, and for individual earnings growing faster or slower than the average, was shown in the first edition of *Pensions at a Glance* (OECD, 2005)

The real rate of return on defined-contribution pensions is assumed to be net of administrative charges. In practice, this assumption might disguise genuine differences in administrative fees between countries (see Whitehouse, 2000 and 2001 for an analysis).

The calculations assume the following for the pay-out of pension benefits: when DC benefits are received upon retirement, they are paid in the form of a price-indexed life annuity at an actuarially fair price. This is calculated from mortality data. Similarly, the notional annuity rate in notional accounts schemes is (in most cases) calculated from mortality data using the indexation rules and discounting assumptions employed by the respective country.

Taxes and social security contributions

Information on taxes and social security contributions which were used to calculate the net indicators for 2002 were included in the country chapters in the first edition of *Pensions at a Glance* (OECD, 2005). The tax and social security contribution rules and parameters have been updated to 2004 but are not repeated in this volume for reasons of space (Fujisawa and Whitehouse, forthcoming 2007, provides more information).

The modelling assumes that tax systems and social-security contributions remain unchanged in the future. This implicitly means that “value” parameters, such as tax allowances or contribution ceilings, are adjusted annually in line with average earnings, while “rate” parameters, such as the personal income tax schedule and social security contribution rates, remain unchanged. General provisions and the tax treatment of workers for 2004 can be found in the OECD report *Taxing Wages* (OECD, 2006). The conventions used in that report, such as which payments are considered taxes, are followed here.

Average earnings

Starting with this edition, *Pensions at a Glance* uses a new and more comprehensive measure of average earnings corresponding to an “average worker” (AW). This is broader than the previous benchmark of the “average manual production worker” (APW). This new concept was introduced in the report *Taxing Wages* (OECD, 2006) and also serves as benchmark for *Benefits and Wages* (OECD, 2007).

The reasoning behind the change was that a manual worker in the production sector is not representative of the “typical taxpayer”, given the steady decline in manual employment in manufacturing in most OECD countries. The new base for calculating average earnings includes more economic sectors and both manual and non-manual workers. The concept and definition of earnings, however, remains the same: gross wage earnings paid to average workers, measured before deductions of any kind, but including overtime pay and other cash supplements paid to employees.

Table 0.1 reports average earnings levels under the old (APW) and new (AW) definition, for the year 2004. Only three countries (Ireland, Korea and Turkey) are not yet able supply earnings data on the broader basis and so the modelling is based on the old, APW measure of average earnings.

The effect of broadening the types of workers covered has very different effects on measured average earnings in different OECD countries. In 19 of the 27 countries for which new, AW data are available, these are *higher* than average earnings under the previous, APW definition but the size of the difference varies greatly (see Figure 0.1). The change in definition increases measured average earnings by 30% or more in six countries (Austria,

Table 0.1. OECD measures of average earnings, 2004
National currency and USD at market price and purchasing-power-parity exchange rates

	OECD measure of average earnings				Exchange rates with USD	
	Old – National currency (APW)	New – National currency (AW)	New – USD, market price	New – USD, PPP	Market price	PPPs
Australia	52 777	48 827	35 922	35 917	1.36	1.36
Austria	24 946	32 872	40 842	37 872	0.80	0.868
Belgium	32 281	35 578	44 205	41 151	0.80	0.865
Canada	40 912	38 945	29 933	31 269	1.30	1.25
Czech Republic	213 573	209 489	8 153	14 936	25.69	14.03
Denmark	323 900	316 500	52 860	37 684	5.99	8.40
Finland	29 152	31 539	39 186	32 372	0.80	0.974
France	23 087	29 549	36 713	32 199	0.80	0.918
Germany	34 088	41 046	50 998	45 898	0.80	0.894
Greece	12 525	17 360	21 569	24 996	0.80	0.695
Hungary	1 262 712	1 697 268	8 377	13 682	202.61	124.05
Iceland	2 849 554	2 770 000	39 463	29 461	70.19	94.02
Ireland	30 170	n.a.	37 485	30 321	0.80	1.00
Italy	23 044	22 053	27 400	25 628	0.80	0.861
Japan	4 223 100	4 943 208	45 708	37 139	108.15	133
Korea	27 356 688	n.a.	23 888	34 974	1 145.20	782
Luxembourg	32 586	39 171	48 668	42 649	0.80	0.918
Mexico	66 432	76 332	6 767	10 446	11.28	7.31
Netherlands	32 457	37 026	46 003	41 300	0.80	0.897
New Zealand	41 778	39 428	26 129	26 793	1.51	1.47
Norway	314 523	366 161	54 332	41 005	6.74	8.93
Poland	26 745	29 263	8 015	15 858	3.65	1.85
Portugal	9 372	12 969	16 113	18 344	0.80	0.707
Slovak Republic	190 000	200 722	6 228	11 679	32.23	17.19
Spain	17 913	19 828	24 635	26 215	0.80	0.756
Sweden	251 282	300 814	40 949	32 773	7.35	9.18
Switzerland	64 419	70 649	56 849	40 900	1.24	1.73
Turkey	13 959	n.a.	9 789	16 788	1.43	0.831
United Kingdom	20 560	27 150	49 747	43 881	0.55	0.619
United States	34 033	30 355	30 355	30 355	1.00	1.00

n.a.: Not available.

AW = average wage.

APW = average production worker.

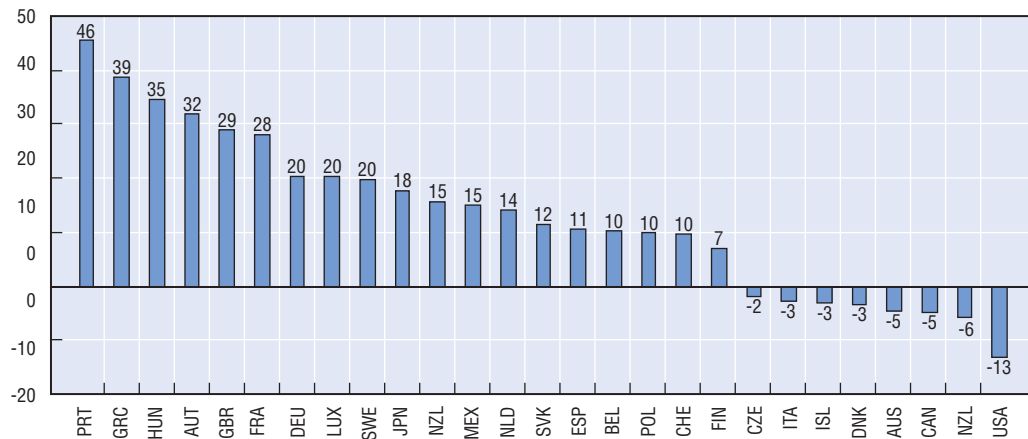
PPP = purchasing power parity.

Note: Monetary values for Turkey divided by 1 000 000. Average earnings are not available on the AW measure for Ireland, Korea and Turkey.


Source: OECD (2006), p. 13; and OECD Main Economic Indicators.

France, Greece, Hungary, Portugal and the United Kingdom). For three additional countries the increase was 20% (Germany, Luxembourg and Sweden). In contrast, a sizeable decrease occurred only in the United States (13%), with more modest declines (of around 5% or less) in seven further countries.*

* Countries have endeavoured to supply data based on the new Average Wage concept. However, as when any new series is introduced, there are teething problems and different interpretations of guidelines need to be reconciled. It appears possible, for example, that the US data excludes some groups that are included in other countries' estimates of the average wage, which may partly explain the surprisingly low US average wage estimate. This issue is subject of ongoing work, and updates to the wage series will be posted on the OECD website as and when they become available.

Figure 0.1. **Percentage difference of average earnings AW levels with regard to previous APW levels, 2004**

Source: OECD (2006), p. 13.

StatLink  <http://dx.doi.org/10.1787/886456570455>Table 0.2. **Total life expectancy at age 65, 2040 projected mortality rates**

	Men	Women
Australia	84.0	87.4
Austria	83.7	87.3
Belgium	83.8	87.3
Canada	83.8	87.4
Czech Republic	82.5	86.0
Denmark	83.1	86.0
Finland	83.6	87.5
France	83.9	87.6
Germany	83.2	86.6
Greece	83.3	86.6
Hungary	80.8	85.0
Iceland	84.8	87.5
Ireland	82.8	86.2
Italy	83.0	87.0
Japan	85.8	88.7
Korea	81.8	85.6
Luxembourg	83.0	87.2
Mexico	80.9	84.8
Netherlands	83.5	86.7
New Zealand	83.6	86.8
Norway	84.2	87.5
Poland	81.5	85.6
Portugal	82.8	86.2
Slovak Republic	81.1	85.1
Spain	83.4	87.0
Sweden	84.3	87.5
Switzerland	84.5	88.2
Turkey	80.0	83.0
United Kingdom	83.3	86.4
United States	83.8	87.3
OECD average	83.1	86.6

Note: These projections build on recent national census data. The assumptions for future changes in mortality rates vary between countries but nonetheless use a consistent methodology. The resulting mortality rates can differ from national projections because of differences in assumptions.

Source: OECD calculations based on United Nations/World Bank population database.

Demographics and life expectancy

Table 0.2 shows the country-specific total life expectancy, separately for men and women, conditional on surviving until age 65. Given that pension entitlements are projected into the future, the calculations use the projections for 2040 from the United Nations/World Bank population database. Workers who enter the labour market in 2004 will retire between 2044 and 2051. Unfortunately, mortality-rate projections are available only for 2040 and 2075.

Citizens of poorer OECD member states are projected to retain lower life expectancies than their counterparts in richer economies. In Hungary, Mexico, Poland, the Slovak Republic and Turkey, life expectancy at age 65 is 1½-3 years shorter than the OECD average. Japan and Switzerland have significantly longer life expectancy than the OECD mean today and are projected to remain at the top in 2040. Other countries are clustered around the OECD average.

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Table of Contents

Editorial: Pension Reform – The Unfinished Agenda	6
Executive Summary	8
Structure of the Report and Methodology	11

Part I

Comparing Pension Policies of OECD Countries

Overview of Retirement-Income Provision	21
Key Features of Pension-System Design	24
Retirement-Income Indicators	31
Gross Pension Replacement Rates	32
Net Pension Replacement Rates	34
Gross Pension Replacement Rates with Entry at Age 25	36
Gross Pension Replacement Rates with Different Investment Returns	38
Gross Pension Wealth	40
Net Pension Wealth	42
Progressivity of Pension Benefit Formulae	44
Pension-Earnings Link	46
Weighted Averages: Pension Levels and Pension Wealth	48
Structure of the Pension Package	50
References	52

Part II

Pension Reforms and Private Pensions

1. A Decade of Pension Reforms: The Impact on Future Benefits	55
1.1. Overview of pension reforms in OECD countries	55
1.2. Impact of pension reforms in selected OECD countries	64
1.3. Conclusions	74
Notes	75
2. The Role of Private Pensions in Providing Future Retirement Incomes	76
2.1. Coverage of private pensions	76
2.2. Types of voluntary private pension provision	79
2.3. Mandatory replacement rates and the pension savings gap	80
2.4. Mandatory replacement rates and private-pension coverage	81
2.5. Filling the retirement-savings gap	82
2.6. Contribution density and the retirement-savings gap	85
2.7. Real rates of return on investments and the retirement-savings gap	86
2.8. Indicative gross replacement rates including voluntary pensions	86
2.9. Conclusions and future developments	88

Notes	89
Annex. Gross Replacement Rates Including Defined-Benefit Occupational Plans	90
References	92

Part III

Country Studies

Introduction	97
Australia	99
Austria	102
Belgium	105
Canada	108
Czech Republic	111
Denmark	114
Finland	118
France	122
Germany	127
Greece	130
Hungary	133
Iceland	137
Ireland	140
Italy	142
Japan	146
Korea	150
Luxembourg	153
Mexico	156
Netherlands	159
New Zealand	162
Norway	165
Poland	168
Portugal	172
Slovak Republic	177
Spain	181
Sweden	184
Switzerland	190
Turkey	194
United Kingdom	198
United States	202

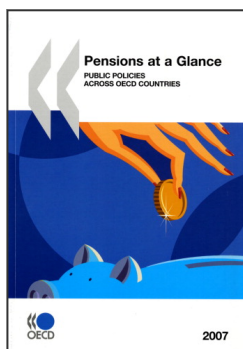
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