



EUROPEAN SOCIAL POLICY NETWORK (ESPN)

Financing social protection

Finland

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EUROPEAN COMMISSION

Directorate-General for Employment, Social Affairs and Inclusion

Directorate C — Social Affairs

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B-1049 Brussels

European Social Policy Network (ESPN)

**ESPN Thematic Report on
Financing Social Protection**

Finland

2019

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The European Social Policy Network (ESPN) was established in July 2014 on the initiative of the European Commission to provide high-quality and timely independent information, advice, analysis and expertise on social policy issues in the European Union and neighbouring countries.

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Quoting this report: Kangas, Olli and Kallioma-Puha, Laura (2019). ESPN Thematic Report on Financing social protection – Finland, European Social Policy Network (ESPN), Brussels: European Commission.

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Summary

Finland is a big spender: its social spending as a share of GDP is the second highest in the EU. Until the international crisis of 2008, Finnish social spending was somewhat below EU-28 levels. But because the economic crisis hit Finland more severely than many other member states, its spending increased by more than in the EU-28. By 2017, the spending level in Finland was 32% of GDP (25.1% in 2008).

In Finland, the government's share of total financing of social spending is higher – and consequently the share of social security contributions is lower – than in most other EU member states. Finland belongs to the 'Nordic welfare state regime' with a wide range of free or heavily subsidised services available to all, and a strong reliance on tax financing. The reliance on taxes goes back to the 1950s. Broadly speaking, the Finnish government finances half of social expenditure, while the other half is financed through contributions. Historically, the share paid by employers was more significant. However, over the past two to three decades there has been a clear shift towards increasing employee contributions and relieving the burden on employers.

In the pension sector, two main reform processes have reduced employer contributions. Until 2010, employers financed almost half of the basic National Pension (NP). While the basic pension reform was being prepared, employer contributions were abolished, and since 2015 the government has borne the entire cost of the NP and of the Guaranteed Pension (GP) that was introduced in 2011. The aim of this reform was to revitalise the Finnish economy, which was still suffering as a result of the 2008 crisis.

In the past, employment-related pensions (introduced in 1962) were financed entirely by employer contributions. However, the economic crisis of the 1990s changed that mode of financing. In 1993, the government introduced employee fees to improve the financial situation of employers. The fee was 3% of gross income. In 1994, the government decided that the cost of successive increases in pension contributions would be borne equally by employers and employees. By 2019, the average employee share has risen to 7.05% of gross income and the employer contribution is 17.35% of the payroll. The biggest part of these contributions is used to finance current pensions, while a smaller part is put in a pensions fund. The financial situation of the pension system is relatively stable, but not without challenges. The rapidly ageing population will continually increase all age-related expenses.

Some options to safeguard the sustainability of the pension system are to: increase employment rates in all age brackets; limit early exits from the labour market; postpone retirements; and perhaps increase the pension age faster than is stipulated by the 2017 pension reform. All of these demand changes in the educational system, in the balance between work and family life, in life-long learning, and in the adaptation of working conditions to recognise the special needs of older employees.

The previous centre-right government tried to carry out a reform of social and healthcare services – the biggest single social policy reform in Finland's history. The aim was to introduce 18 new administrative domains – counties – between the central government and the municipalities. According to the government's plan, the responsibility for healthcare and social services, including long-term care, would be transferred to the 18 counties. The hope was that the reform would reduce the future expansion in social spending by €3 billion by 2025. However, the reform proposal encountered several constitutional and other legal problems, and was not passed by the parliament. As a consequence, the government resigned on 8 March 2019. Parliamentary elections were due to be held on 14 April 2019. The new government that will be nominated after the elections will have the responsibility for finalising the reform and securing the sustainability of the Finnish welfare state.

1 Current levels and past changes in financing social protection

1.1 Social spending

The aim in this section is to describe current levels and past changes in social spending in Finland. All statistical information presented in this report is based on the 'European System of integrated Social PROtection Statistics' (ESSPROS) data. If national sources are used, it is clearly indicated in the references.

In Finland, the share of social spending in GDP (32% in 2016) is the second biggest among the EU member states. Only in France (34.3%) is the spending level higher than in Finland. The EU-28 average is 28.2%. In Finland, social benefits – with the exception of social assistance, housing allowances and child benefits – are subject to taxation, like any other income. Therefore, the net spending rate is lower (by 3.5 percentage points in 2015) than the gross spending rate. The EU-28 difference between the gross and net spending rates is smaller (2.2 percentage points). Nonetheless, even on the basis of net spending, Finland is still the second-biggest spender on welfare after France.

Up to the international crisis of 2008, Finnish social spending was slightly below EU-28 levels (Figure 1). Since the crisis, the EU-28 spending level has stabilised at 28-29% of GDP, whereas in Finland spending rapidly increased (from 24.5% to 30.1% in 2012). There are several reasons for the expansion of social spending in relation to GDP. The overall explanation is that the numerator grew while the denominator shrank.

The 2008 crisis hit Finland harder than most of the other European economies. From 2008 to 2009, GDP decreased by nearly 10%. The following economic recovery (2010 to 2011) was short-lived and there were several consecutive years of negative growth. Not until 2016 did GDP begin to grow again (Findicator, 2019a).

Figure 1. Social spending in Finland as a share of GDP (%) (left-hand axis) and real growth of spending (2005 = 100) (right-hand axis)



Source: ESSPROS database

As a consequence of sluggish economic growth, the unemployment rate increased from 6.1% in 2007 to 8.8% in 2015, before dropping to 7.5% in 2016 and further to 5.7% in 2018 (Findicator, 2019b). Somewhat surprisingly, the share of GDP spent on those social security schemes that are most closely linked to unemployment (i.e. unemployment benefits, housing allowances and social assistance) increased by 'only' 2.0 percentage points between the pre-crisis year 2007 and 2016 (from 2.5% to 4.5% of GDP: THL, 2018). No doubt, unemployment is an important driver of the expansion in spending, but

it is not the main driver. While real spending on the three unemployment-related benefits schemes increased by 71% (from €5.9 billion in 2007 to €9.6 billion in 2016), the increase in spending on pensions was as much as 106% (from €17.8 billion to €27.7 billion). Health spending increased more moderately (by 16%, from €13.4 billion to €15.5 billion: THL, 2018). Due to the rapid increase in pensions spending, 'old age' now accounts for 41% of the total Finnish social budget (ESSPROS data). The rapidly growing population, and improving pension rights, will further increase pension spending, which will make it more difficult to finance other functions of the welfare state. This issue will be dealt with in more detail in section 3.

In relation to GDP, means-tested benefits play a minor role in Finland (0.02% in 2016). However, their share of gross expenditure on social protection increased from 4.4% in 2010 to 6.5% in 2016. The increase was due to rising long-term unemployment. When income-related unemployment benefits terminate after 500 benefit days, the long-term unemployed are entitled to basic unemployment benefits. The benefit level is often so low that the unemployed will get social assistance. Thus, the higher the long-term unemployment, the higher the expenditure on social assistance.

In Finland, virtually all social spending is based on statutory benefits, and the role of private benefits is minimal; that is, mandatory or voluntary private schemes are not important in Finland. The same goes for various forms of tax expenditure.

In section 2, our focus is on developments in the financing of old-age pensions (2.2) and healthcare and sickness benefits (2.3). A cursory overview of changes in other programmes is given in section 2.4.

There are specific reasons to discuss pensions and healthcare in greater detail. The Finnish population is getting older more quickly than in most of the other member states. Therefore, there are severe challenges in financing future pensions. A greying population also means increases in health spending.

1.1.1 Expanding spending on pensions: challenges for the sustainability of the welfare state

Table 1 depicts the gross spending levels on old-age benefits. Over the course of 10 years, social spending on old age increased by 4.3% of GDP, and by as much as 7.2% of total social spending – in 2015 it accounted for over 40% of the latter. The main drivers behind this development were the increasing number of retirees with full pension rights (due to the maturation of employment-related pensions) and the increasing number of people older than 65.

Table 1. Gross spending on old age in Finland (FI) and the EU-28, 2005 to 2015

Spending	2005	2008	2010	2015	Change 2005 to 2015 (percentage points)
% of GDP, FI*	8.3	8.4	10.2	12.6	+4.3
% of total social spending, FI	33.6	34.6	35.9	40.8	+7.2
% of total social spending, EU-28	38.6	39.4	39.1	40.1	+1.5

Source: ESSPROS database; *THL, 2018

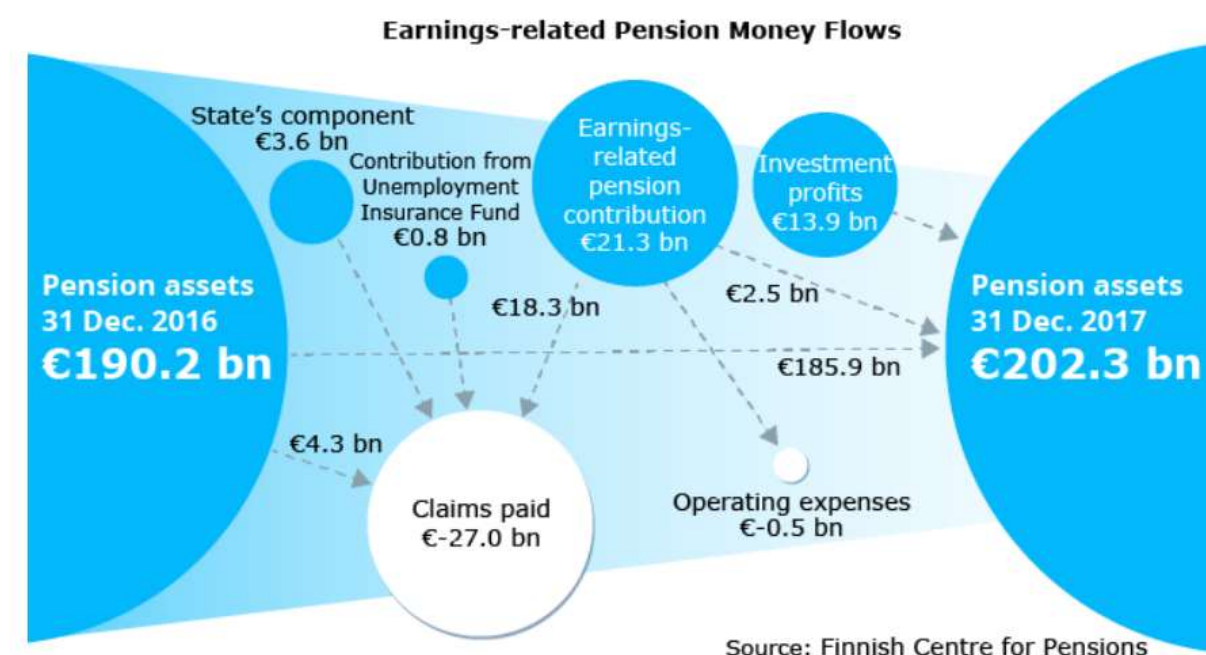
In 2005, there were 793,366 persons receiving the National Pension (NP). By 2016, this number had fallen to 654,691 (Kela, 2018, 96). This diminishing number of recipients was due to the characteristics of the NP. The NP is tested against all other pension income, and if income from employment-related pensions exceeds a certain threshold, the NP is no longer paid. There are more and more retired people whose employment pensions are high enough to exclude them from the NP system (579,841 in 2005 and 867,286 in 2016). The total number of pensioners was 1.2 million in 2005 and 1.4 million in 2016 (Kela, 2018, 51).

Another main driver increasing pension spending is the rapid demographic change in Finland. In 2005, the share of people aged 65+ was 16.0%, and in 2016 it was 20.9% (Statistics Finland, 2006 and 2018). The Finnish population is rapidly getting older. According to population projections, in 2040 the share of people older than 65 will be close to 30%. The latest release from Statistics Finland (2019) reports that the total fertility rate in 2018 was 1.40, which is the lowest rate ever measured. This low fertility rate means that the share of the elderly population may increase much more, and much more quickly, than anticipated. Needless to say, this will cause severe problems for the economic sustainability of the Finnish welfare state.

In 2017, the total sum of pensions paid was €27.0 billion. The lion's share (€18.3 billion) was covered from contributions, of which employers and employees paid the biggest portion. The state pays pension contributions for periods of study and periods of childcare. The Unemployment Insurance Fund covers the costs arising from pension fees paid in addition to employees' unemployment and training allowances (Figure 2).

€2.5 billion of contributions was put in pension funds. The earnings-related pension funds are invested mainly in Finnish and foreign shares, bonds and real estate. Returns (€13.9 billion in 2017) are reinvested in pension funds as shown in Figure 2. In Table 6, we give a more detailed description of the principles according to which revenues from different sources were collected between 2006 and 2018.

Figure 2. Employment-related pension revenues and benefits paid in Finland, 2017 (€ billion)



Source: ETK, 2018; Vanne, 2017, 222

1.1.2 Healthcare: moderate growth in spending but pending changes in the institutional structure of healthcare

Spending on healthcare in Finland is close to the EU-28 average. In relative terms, Finland spent 9.2% of GDP on healthcare in 2017, and in absolute terms €3,013 (PPP) per capita. The corresponding numbers for the EU-28 were 9.6% and €2,773 (OECD, 2018). As can be seen in Table 2, the share of healthcare spending in total social spending was lower in Finland in 2005-2015 than in the EU-28; and whereas the share fell in Finland (by 3.3 percentage points), it increased slightly in the EU-28 (by 0.7 percentage points).

Table 2. Gross spending on healthcare in Finland (FI) and the EU-28, 2005 to 2015

Spending	2005	2008	2010	2015	Change 2005 to 2015 (percentage points)
% of GDP FI*	6.4	6.5	7.2	7.2	+0.8
% of total social spending, FI	25.9	26.7	25.1	22.6	-3.3
% of total social spending, EU-28	28.7	29.3	29.1	29.5	+0.7

Source: ESSPROS database; *THL, 2018

The Finnish healthcare system is currently undergoing major institutional changes. The social and healthcare reform ('SOTE' reform) will significantly change the institutional structure of social and healthcare services. The centre-right government led by Mr. Juha Sipilä failed to carry out the reform designed to shift responsibility for managing healthcare from municipalities to newly created counties, a new administrative level between central government and local municipalities. However, no major changes were planned in sickness cash benefits. The aim was to reduce the future expansion in spending on social and healthcare services by €3 billion by 2025. (Kangas and Kallioma-Puha, 2018). Due to several constitutional and other legal problems, the SOTE legislation was not approved. As a consequence, the government resigned on 8 March 2019. Parliamentary elections were due to be held on 14 April 2019. The new government that will be nominated after the elections will have the responsibility of finalising the reform. At this point it is not clear what the economic burdens will be or how they will be distributed after the reform.

1.1.3 Increasing unemployment causes expansion in spending

Table 3 depicts gross spending levels on benefits related to housing, families, unemployment and social exclusion. Needless to say, increasing unemployment is the main driver in spending on unemployment, but unemployment is also one of the main drivers in increasing spending on housing and means-tested benefits.

It can be seen that the share of housing in total social spending in Finland was lower than in other EU member states in 2005: but due to a rapid increase thereafter, the Finnish share was higher in 2016. The drivers of the increase were the increasing number of benefit recipients (due to increasing unemployment after the 2008 recession) and the housing allowance reform carried out in 2015. The reform improved benefits and expanded the coverage of the scheme. Consequently, in 2016 housing spending in relation to GDP was almost three times higher than in 2005. Higher levels of unemployment and cuts in basic security benefits explain increases in spending on means-tested programmes.

Table 3. Gross spending on benefits related to housing, families, unemployment and social exclusion in Finland (FI) and the EU-28, 2005 to 2015

Spending	2005	2008	2010	2016	Change 2005 to 2016 (percentage points)
Housing					
% of GDP, FI*	0.3	0.4	0.5	0.8	+0.5
% of total social spending, FI	1.1	1.6	1.7	2.4	+1.3
% of total social spending, EU-28	2.0	2.0	2.1	2.0	0.0
Family					
% of GDP, FI*	2.9	2.8	3.1	3.1	+0.2
% of total social spending, FI	11.6	11.6	11.1	9.9	-1.7
% of total social spending, EU-28	8.4	8.6	8.6	8.7	+0.3
Unemployment					
% of GDP, FI*	2.3	1.7	2.3	2.6	+0.3
% of total social spending, FI	9.3	7.1	8.2	8.2	-1.1
% of total social spending, EU-28	5.8	5.0	6.0	4.8	-1.0
Means-tested programmes					
% of GDP, FI	0.01	0.01	0.01	0.02	+0.01
% of total social spending, FI	5.1	4.2	4.4	6.5	+1.4
% of total social spending, EU-28	10.3	11.8	12.1	12.1	+1.8

Source: ESSPROS database; *THL, 2018

2 Current mix and past changes in the sources for financing social protection

The 2008 international crisis hit the Finnish economy severely. As a consequence, financing the welfare state has been problematic. The state budget, which in 2008 recorded a surplus of 4.2% of GDP, has since 2009 been in deficit (by as much as 3.2% of GDP in 2014). The public debt skyrocketed from 32.7% of GDP in 2008 to 63.6% in 2015. By 2017, the general government deficit was 0.7% of GDP, and the consolidated gross debt was 61.3%. The ratio of debt to GDP went above the EU reference value of 60% during 4 years, but it has fallen in the last 2 years (Findicator, 2018).

Institutional changes in the social security system and economic trajectories have caused changes in the emphasis of financing for social spending. As shown in Appendix Table 1, there has been a clear shift from employer contributions towards financing via government contributions and contributions collected from insured people themselves. This shift is even clearer if we look further back in history. In 1980, employers financed 49.6% of total social spending. The share of the government was 36.6%. Contributions from insured people corresponded to 7.7%. In 2016, the shares were 33.8, 47.9 and 13.3%, respectively. The overarching rationale behind this development is the wish to relieve the financial burden on employers, to be better adapted to globalisation and technological developments, and to share the costs caused by the ageing population.

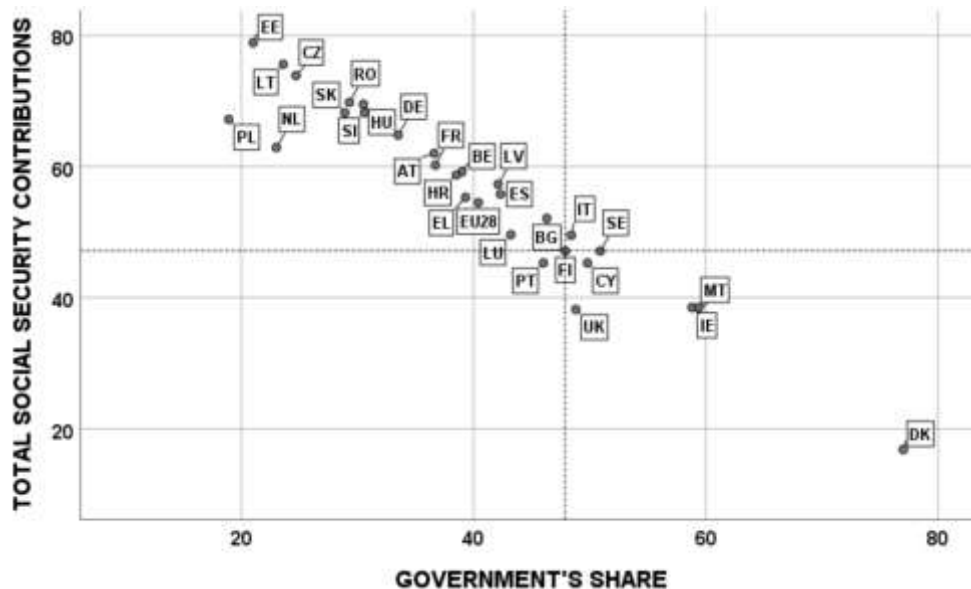
The aim in the following sections is to describe the current institutional structures for financing social protection spending, and the way these structures changed between 2005 and 2016. We first describe some general trends (section 2.1). Thereafter the emphasis is on pensions (section 2.2) and healthcare benefits (section 2.3). Section 2.4 gives a short summary on developments in financing other social security schemes.

2.1 Mix in financing of the welfare state

In comparative studies on welfare state regimes, Finland has been placed in the Nordic 'Social Democratic' regime, which is characterised by a high degree of universalism, rather generous social benefits, a wide range of free or heavily subsidised services available for all, and a strong reliance on tax financing (Kautto, 2009; Kangas and Kvist,

2018). To some extent, ESSPROS data do support this typology. Figure 3 presents a scatterplot of the EU-28 member states. Whereas the horizontal axis depicts the share of social security contributions coming from the government, the vertical axis shows the total social security contributions collected from employers, employees, self-employed people, and benefit recipients.

Figure 3. The share of social security contributions and of the government in total social security revenues (%) in EU-28, 2016



Source: ESSPROS database

As can be seen in the figure, in 2016 the government's share in the financing of gross social security expenditure was almost 10 percentage points higher in Finland (47.9%) than in most of the other member states (the EU-28 average was 40.4%). Correspondingly, the role of social security contributions in Finland was lower (47.1%) than the EU-28 average (54.5%). Thus, the data do somewhat validate the typology for the financing of social security in different welfare state regimes: the general government share of financing in the Nordic area is higher than in most other EU countries.

Table 4 gives a breakdown of the relative role of different forms of finance for social expenditure, as well as the total change in each form between 2005 and 2016. The share of social security contributions declined year by year (by 2.6 percentage points over the whole period). While revenues from the government declined up to the year 2008, by 2016 they had increased by 5.0 percentage points. Correspondingly, the share of other revenues (mostly consisting of dividends from pensions and other social security funds) grew in importance until 2008, before declining during the years of economic crisis.

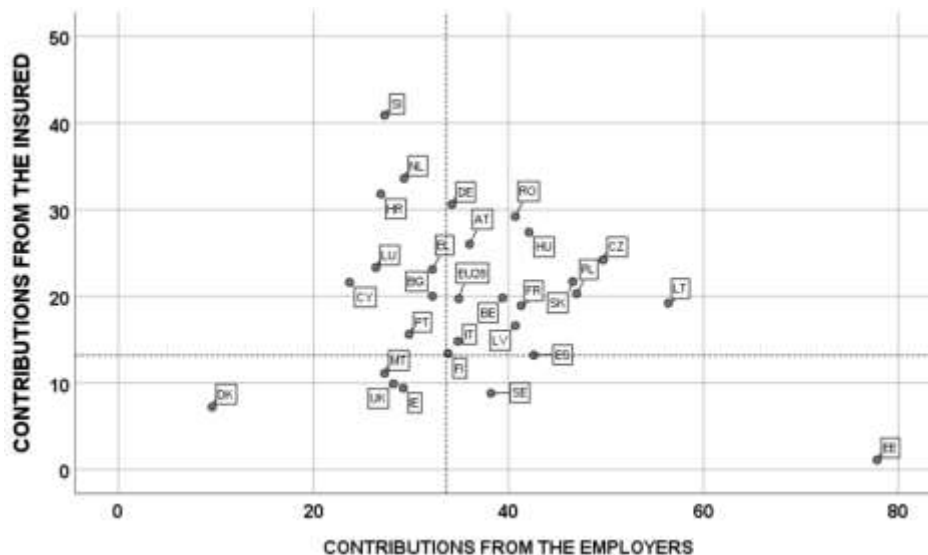
Table 4. Financing of total social expenditure 2005 to 2016 in Finland: shares of social security contributions, revenues from the general government, and 'other' (%)

Year	Social security contributions	General government	Other
2005	49.7	43.4	6.9
2008	48.5	42.9	8.6
2010	47.8	46.2	6.0
2015	47.2	47.8	5.0
2016	47.1	47.9	5.0
Change (percentage points)	-2.6	+4.5	-1.9

Source: ESSPROS database

In addition to the important role of tax financing, the trademark feature of the Nordic welfare state model is said to be a low share of social security contributions paid by insured people themselves. Figure 4 displays separately the shares paid by employers and by insured people (which is the sum of contributions paid by employees, the self-employed, and insured persons).

Figure 4. The share of total social security contributions coming from employers and from insured people in EU-28, 2016 (%)



Source: ESSPROS database

As can be seen, insured people's share in all the Nordic countries, including Finland (13.4%), was lower than the EU average (19.7%). However, there are two qualifications to this conclusion. First, the government's share consists of direct and indirect taxes, which are also collected from insured people. Thus, the financial burden of insured people in Finland, as in the other Nordic countries, is much heavier than the vertical axis in Figure 4 indicates. Second, as said in section 1.1, the Finnish state collects taxes on most social security transfers. This 'claw-back' effect means that benefit recipients are further helping to finance social security expenditure, in contrast to many other countries. In Finland, the tax on social security transfers was stable throughout the period under inspection (9.5% in 2007 and 2015). The same goes for social security contributions collected from benefit recipients (1.1% in 2007 and 1.0% in 2015).

The declining role of social security contributions, shown in Table 5, is due to the reduced burden on employers, whose share went down from 38.4% in 2005 to 33.8% in 2016. As a result, their share was very close to the EU-28 average (34.9%) in 2016. The reduced burden on employers was compensated for by increases in the shares of employees, the self-employed, and the government. Revenues collected from benefit recipients remained stable throughout the whole period.

Table 5. Shares of total social security contributions, Finland 2005-2016 (%)

Year	Employers	Employees	Self-employed	Benefit recipients
2005	38.4	8.6	1.7	1.0
2008	37.5	8.3	1.7	1.0
2010	35.7	9.3	1.8	1.0
2015	34.0	10.1	2.1	1.0
2016	33.8	10.3	2.1	1.0
Change 2005 to 2016 (percentage points)	-4.6	+1.7	+0.4	0.0

Source: ESSPROS database

2.2 Current mix of financing for old-age benefits: more emphasis on contributions from insured people and the government

The Finnish pension system consists of two parts: the basic pensions (the National Pension and the Guaranteed Pension [GP]) and employment-related pensions. There are a number of employment/earnings-related pension schemes: TyEL is for employees in the private sector, VeL is for state employees and KvTEL is for local government employees. In addition, there are separate schemes for self-employed people (YeL) and for farmers (MyEL).

The NP and GP are based on the defined-benefit principle, and they are financed by the government. The NP and GP are pay-as-you-go systems. The financial structure of employment-related pensions is more complicated, and the financing here is a mixture of pay-as-you-go and funded schemes (Figure 2). With its pension funds comprising up to 90% of GDP, Finland has one of the biggest pension reserves of OECD countries.

Employer contributions to the NP were abolished in 2010 after the Employer Federation and the Central Confederation of Trade Unions agreed on a 'social pact' in 2009. This pact included an agreement to gradually increase contributions to employment-related pensions. The increase was to be equally distributed between employers and employees. Furthermore, the social partners agreed not to introduce cuts to earnings-related unemployment benefits. Thus, the pact was a win-win deal for both sides: while the pact relieved the burden on employers by nearly €1 billion and transferred the costs to the state, the trade unions retained employment-related pensions and unemployment benefits. The pension reform of 2017 further increased employee contributions (from 4.5% to 6.35%, or from 5.7% to 7.85%, depending on the employee's age) and slightly reduced employer contributions (from 17.1% to 17.75%). Most probably, future increases in contributions will continue to be targeted at employees, with the aim of ensuring employers' competitiveness in the face of global challenges.

Table 6. Pension contribution rates in Finland, 2005-2018

		2006	2010	2018
Social security contributions	Employers	NP: 0.898-3.995% of payroll; 21.6% if fewer than 50 employees; 19.75-23.3% if 50+ employees; exempted if income less than €235.76 a year; no ceilings.	NP: none; average contribution is 17.1% of payroll; exempted if income less than €51.57 a month; no ceilings.	NP & GP: none; average contribution is 17.75% of payroll; no ceilings.
	Employees	4.6% of earnings if younger than 53; 5.8% for older employees; exempted if income less than €235.76 a year; no ceilings.	4.5% of earnings if younger than 53; 5.7% for older employees; exempted if income less than €51.57 a month; no ceilings.	6.35% of earnings if younger than 53; 7.85% for older employees; exempted if income less than €58.27 a month; no ceilings.
	Self-Employed	21.4% if younger than 53; 22.6% if older; exempted if income less than €5,658.27 a year. Farmers: 10.5%; exempted if income less than €2,829.14 a year. Ceiling for benefit purposes: €94,391.37 a year.	21.2% if younger than 53; 22.6% if older; exempted if income less than €5,658.27 a year. Farmers: 10.5%; exempted if income less than €2,829.14 a year. Ceiling for benefit purposes: €94,391.37 a year.	24.1% if younger than 53 or older than 62; 25.6% if aged 53-62; exemptions: farmers earning less than €3,838.13 a year; self-employed earning less than €7,656.26 a year. No ceilings.
Government	40% of costs of NP, and total costs for persons on home care allowance and students in degree programmes.	Total costs of NP, GP, persons on home care allowance and students in degree programmes.	Total costs of NP, GP, persons on home care allowance and students in degree programmes.	

Source: MISSOC, 2019; SSA, 2006 and 2010

In Finland, all earnings accumulate pension rights and hence are subject to contributions. However, very low earnings are exempted from contributions. Employees with very low earnings are covered by the basic pension system (NP and GP). The Finnish income transfer system is rather unique. It has income ceilings for neither contributions nor benefit purposes. Pensions – like all other earnings-related transfers – are earnings-related without any caps. Due to the system's total income-relatedness, there has been no need to create private occupational schemes for high-income earners (see e.g. Kangas, 2007).

Table 7 depicts the gross spending levels for old-age benefits and the distribution of the financial burden between different sources. Over the course of 10 years, social spending on old age increased by 4.3% of GDP. The share of old age in total social spending increased by as much as 7.2 percentage points, and old age accounted for over 40% of total spending in 2015. The main drivers behind this development were the increasing number of retirees with full pension rights (due to the maturation of the employment-related pensions) and the increasing number of people older than 65 years of age (see section 1.1.1).

In 2005, there were 793,366 persons receiving National Pensions (NP). In 2016, this number was down to 654,691 (Kela, 2018, 96). This diminishing number of recipients is due to the characteristics of the NP. The NP is tested against all the other pension income, and if income from employment-related pensions exceeds a certain threshold, the NP no longer gets paid. There are more and more retired people who only have their

employment pensions, which are high enough to exclude them from the NP system (579,841 in 2005 and 867,286 in 2016). The total number of pensioners was 1.2 million in 2005 and 1.4 million in 2016. (Kela 2018, 51).

Table 7. Gross spending on old age and shares of different financial sources in Finland, 2005 to 2015 (%)

Spending and financial source	2005	2008	2010	2015	Change 2005 to 2015 (percentage points)
Spending on old age					
% of GDP*	8.3	8.4	10.2	12.6	+4.3
% of total social spending	33.6	34.6	35.9	40.8	+7.2
Shares of financing					
Government	17.4	16.5	19.4	19.6	+2.2
Contributions	70.6	69.5	69.2	70.4	-0.2
Other	11.9	15.0	11.4	10.0	-1.9
Shares of contributions					
Employers	80.2	81.0	78.9	74.2	-6.0
Employees	15.7	14.9	16.6	20.5	+4.8
Self-employed	4.1	4.1	4.5	5.2	+1.1
Recipients	0	0	0	0	0

Source: ESSPROS database; *THL, 2018

Another main driver increasing pension spending is the rapid demographic change in Finland. In 2005, the share of 65+ people was 16.0 percent, and in 2016 it was 20.9 percent. (Statistics Finland, 2006 and 2018). The Finnish population is rapidly getting older. According to population projections, in 2040 the share of people older than 65 years of age will be close to 30 percent. The latest release from Statistics Finland (2019) reports that the total fertility rate in 2018 was 1.40, which is the lowest rate ever measured. This low fertility rate means that the share of the elderly population may increase much more and much faster than anticipated. Needless to say, this will cause severe problems for the economic sustainability of the Finnish welfare state.

There have been two main reforms – or more correctly, series of reforms – that have affected the distribution of the burden of financing pensions in Finland. The first was the introduction of the GP in 2011. The GP was intended to support those pensioners who were only receiving the NP as their source of income. When preparing this reform, employer contributions were gradually reduced and finally abolished altogether. One motivation behind this process was to revitalise the Finnish economy, which had been hit hard by the 2008 international crisis. In 2005, employers' share of financing the NP was 45.8%. The state paid 40.4%, and the rest came mainly from value added taxes. In 2010, employer contributions made up only 1.3%, and since then the state has been the only financial source for both the NP and the GP (Kela, 2018, 243).

The second set of reforms affecting the distribution of financing has been a series of changes in the TyEL scheme. When employment-related pensions were introduced in 1962, they were entirely employer-financed. In 1993, in the middle of a deep economic recession, the government introduced employee fees to relieve the financial situation of employers and to ensure the sustainability of the TyEL system. This fee consisted of 3% of gross income. In 1994 the government decided that successive increases in pension contributions should be split equally between employers and employees. In 2019, the average employee share is 7.05% of gross income and the employer contribution is 17.35% of the payroll. As can be seen in Table 7, employers' share of contributions has decreased by six percentage points during a decade and correspondingly the share of the insured has increased.

2.3 Current mix of financing for healthcare expenditure: more emphasis on contributions from insured people and the government

Healthcare benefits and services are universal in Finland: all residents are covered by public healthcare and are compensated for the costs of medications and the use of private healthcare services. The current healthcare system is decentralised, gets funding from different public sources (under 'Government' in Table 8) and operates at several levels: 1) municipalities are responsible for providing and financing primary care; 2) 21 healthcare districts are responsible for specialised, intensive care; 3) five university hospitals cover very demanding care; 4) a subsidised (private) occupational healthcare system covers the entire labour force (excluding the unemployed); and 5) there is compensation for visits to private health and dental care providers, and reimbursements for the costs of medications. As Table 8 indicates, all residents – be they employers, employees, self-employed people or pensioners – pay contributions to the healthcare system. However, pensioners are exempted from paying contributions to cash benefits.

As in the case of the pension system, there has been a tendency to reduce employer contributions and to shift the burden to insured people. Whereas the employer contribution rate fell from 2.06% in 2006 to 0.86% in 2018, the employee fee rose from 0.77 to 1.53%.

There is also a growing trend towards private health insurance policies. More than half of the families with children have a healthcare policy for their children and about one fifth of the adult population has a private policy to cover the costs of medical treatment: two thirds are taken out by individuals themselves and one third by employers for their employees.

The whole healthcare system is undergoing a substantial reform. But at the moment it is not clear whether parliament will accept the proposed legislation, or what the possible consequences would be for the sources of financing if it does.

Table 8. Contributions to healthcare benefits in Finland, 2005-2018

		2005	2010	2018
Social security contributions	Employers	Cash benefits: 2.06% of monthly payroll. No minimums or ceilings. Medical benefits: none.	Cash benefits: 2.23% of monthly payroll. No minimums or ceilings. Medical benefits: 2.25 of monthly payroll.	Cash benefits: 0.86% of monthly payroll. Medical benefits: none.
	Employees	Cash benefits: 0.77 of monthly earnings; no minimums or ceilings. Medical benefits: 1.50% of monthly earnings; no minimums or ceilings	Cash benefits: 0.92% of monthly earnings; no minimums or ceilings. Medical benefits: 1.47% of monthly earnings; no minimums or ceilings.	Cash benefits: 1.53% of earnings; minimum income for calculation €14,020 a year, no ceilings. Medical benefits: 1.30% of monthly income.
	Self-Employed	Cash benefits: 0.77 or 1.02% of monthly earnings; no minimums or ceilings. Medical benefits: 1.50% of monthly earnings.	Cash benefits: 0.93 or 1.47% of monthly earnings; no minimums or ceilings. Medical benefits: 1.47% of monthly earnings.	Cash benefits: 1.53% for farmers, 1.70% for other self-employed. Minimum income for calculation €14.020 a year, no ceilings. Medical benefits: 1.30% of monthly income.
	Recipients	Cash benefits: none. Medical benefits: 1.50% of income; no minimums or ceilings.	Cash benefits: none. Medical benefits: 1.64% of income; no minimums or ceilings.	Cash benefits: none. Medical benefits: 1.53% of income; no minimums or ceilings.
Government	Cash benefits: covers all deficits. Medical benefits: 50% of benefits in kind; all costs for municipal healthcare.	Cash benefits: covers all deficits. Medical benefits: 50% of benefits in kind; all costs for municipal healthcare.	Cash benefits: covers all deficits; covers 100% for basic sickness allowance. Medical benefits: 44.9% of benefits in kind; all costs for municipal healthcare.	

Source: MISSOC, 2019 SSA, 2006 and 2010

Table 9. Gross spending on healthcare and shares of different financial sources in Finland, 2005 to 2015 (%)

Spending and financial source	2005	2008	2010	2015	Change 2005 to 2015 (percentage points)
Spending on healthcare					
% of GDP*	6.4	6.5	7.2	7.2	+ 0.8
% of total social spending	25.9	26.7	25.1	22.6	-3.3
Shares of financing					
Government	70.9	70.1	69.0	69.5	-1.4
Contributions	29.1	29.9	31.0	30.5	+1.4
Other	0	0	0	0	0
Shares of contributions					
Employers	71.5	64.9	62.2	65.5	-6.0
Employees	18.9	24.4	26.5	23.0	+4.1
Self-employed	1.7	2.0	2.3	2.0	+0.3
Recipients	7.9	8.7	9.0	9.5	+1.6

Source: ESSPROS database; *THL, 2018, appendix table 7

2.3.1 Stability in financing for housing and social exclusion, changes in other programmes

When it comes to spending on benefits related to housing and social exclusion, there have been no major changes to the division of financing: the government bears the burden (THL, 2018). In the case of survivors' benefits, the role of social security contributions has increased somewhat. Since survivors' benefits are linked to pension insurance, these shifts in financing mirror the changes that have taken place regarding pensions (as explained in 2.1).

Regarding disability benefits, there is a clear tendency for a shift in financing from social contributions (58.3% in 2005 and 40.8% in 2015) to government revenues (32.3% and 54.3%, respectively; see THL, 2018). This is due to shifts in the composition of the recipients. The number of recipients of disability benefits fell between 2005 and 2015, but the fall was greater among those who were insured under the employment-related pension scheme (financed by contributions) than among those who were entitled to basic disability benefits (financed by the government).

A similar trend is visible with regard to unemployment benefits (THL, 2018). The reason here is the same as for the disability benefits. The number of persons getting basic unemployment benefits increased, and hence the government now bears a greater financial burden.

In contrast to disability and unemployment, the role of social security contributions in financing family benefits increased (from 9.2% in 2005 to 20.9% in 2015; THL, 2018). Correspondingly, the share of the government decreased (90.8% in 2005 and 79.1% in 2015). This expanding role of contributions was due to increased contributions paid by employers (5.1% in 2005 and 13.0% in 2015) and employees (3.1% and 5.1%, respectively).

3 Strengths and weaknesses of the existing mix of financing options and potential future sources of financing - national debate on the topic

The main challenges for the Finnish welfare state are related to its *adaptability* to demographic changes. The population is rapidly ageing: the 'big' post-war generations born in the 1940s were followed by 'small' generations. The strength of the Finnish pension system is that there are substantial pension funds in place to form a buffer against the consequences of the anticipated unbalanced demographic development. Furthermore, the 2017 pension reform streamlined the Finnish pension system and introduced 'double links': 1) future pension age is linked to life expectancy; and 2) there is a life-time coefficient that reduces the amount of the monthly pensions that are paid. Pension funds are rather huge and they form a buffer against the impacts of structural changes; they can to some extent mitigate the imbalance between generations. The 2017 reform improved the sustainability of the Finnish pension system, which the Melbourne Mercer Global Pension Index (2018) classified as the third best in the world (after Denmark and the Netherlands).

However, the speed and depth of demographic developments came as a bit of a surprise. The Finnish fertility rate has been at a good level of 1.7-1.8, but the latest data display a more serious picture. There is a rapid trend towards much lower fertility rates. By 2018, the rate had dropped to 1.5 (Statistics Finland, 2019). It goes without saying that this demographic trajectory, with increasing age-related expenditure, gives a gloomy picture of the future financial situation of the Finnish social security system. The system is strong, but it is facing serious challenges.

On 4 February 2019, the Ministry of Finance (Valtiovarainministeriö, 2019) published a report 'Uudistuva, vakaa ja kestävä yhteiskunta' [A renewable, stable and sustainable society]. According to the report, Finland has been a success story over the past hundred years. However, it also claims that 'in the coming years and decades, Finland will face many difficult problems such as climate change, population ageing, technological changes, and high structural unemployment. In addition, public financial buffers for the next recession are slim and the sustainability problem has not yet been resolved.' The current public debt is at 60% of GDP, and the sustainability deficit up to 2050 is calculated to be 4% of GDP. This means that by the year 2050 either taxes should be increased by 4% of GDP or benefits should be cut by the same amount. Thus, *the adaptability to demographic and economic swings de facto is limited.*

The report states that the financial situation is stable but not without risks. There are no problems whatsoever related to *financial evasion*. The collection of contributions for all schemes is tight. However, the present rate of contributions towards the private sector TyEL pensions is already rather high (24.4% of the payroll), and if it were to be increased this would seriously limit the financing of other welfare sectors. Furthermore, higher pension contribution rates *increase labour costs* and may *create serious work disincentives*.

One precondition for safeguarding the sustainability of the pension system is increased employment rates in all age brackets, to limit early exits from the labour market, to postpone the retirement age, and perhaps to increase the pension age faster than is stipulated in the 2017 pension reform. All this demands changes in the educational system (to get youngsters more quickly from education into employment), changes in the balance between work and family life (more flexible day care services for children of more flexible workers), the promotion of life-long learning, and adaptation of the working culture to recognise the special needs of older employees. The target is to reach an employment rate of 75% by 2025 (in 2019 the employment rate is 72%)¹.

¹ The government's target was criticised by some researchers for not having sufficiently taken into account the poor or the effects of climate change; Helsingin Sanomat (2019).

In principle, Finnish social security is universal – whether it be a question of benefits in kind or benefits in cash – and it does not make a distinction between employees, the self-employed and any other form of employment. Hence, at least in principle, all forms of employment are covered. Furthermore, benefits calculations are mostly homogenised. For example, pensions are calculated more or less in the same way, but due to differences in career paths and incomes, which form the basis for pension calculations, outcomes in terms of the actual level of pensions are significantly lower among the self-employed than among employees.

Even though the Finnish social security system covers emerging non-standard workers rather well, some problems can be recognised. The first concerns the level of the benefits. Since the system is a dual one, with basic and earnings-related benefits, those outside permanent, full-time jobs often end up getting lower basic benefits. Thus, from *the distributional point of view* the crucial question is the level of basic benefits.

The second problem is that, for the self-employed, the declared income on which social security contributions for income-related benefits are calculated forms the basis for calculating other social benefits, and therefore the consequence of paying contributions only on a lower declared income may be inadequate social protection. As a result, the self-employed are often inadequately insured against old age, sickness, accidents at work, pregnancy and unemployment. Initiatives are also required to improve the access to sickness benefits. Those without standard employment contracts have long waiting periods, unless they have signed up for complementary insurance. To be able to cater for these extra insurance policies, one has to be quite well informed. Thus, if new forms of employment continue to expand in a digital economy, both sources of financing (the *risk of evasion* may increase) and adequacy of benefit levels may be insufficient, leading to increasing poverty risks. Furthermore, if the prognoses of Thomas Piketty (2014) and Guy Standing (2016) on the increasing importance of capital *vis-à-vis* labour in the functional income distribution and on the expansion of precarious employment will materialise, financing social security by payroll taxes or contributions may run into problems. However, up to now, there are no signs that such a huge change is taking place in Finland.

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Appendix

Appendix Table 1. Division of financing of social protection by main source in Finland, 2005-2015 (% of total financing)

Social protection scheme	Year	Social contributions	Government revenues	Other
Survivors	2005	78.9	5.6	15.5
	2015	82.3	5.3	12.3
Disability	2005	58.3	32.3	9.4
	2015	40.8	54.3	4.9
Unemployment	2005	45.1	49.4	5.5
	2015	36.2	63.8	0.0
Family and children	2005	9.2	90.8	0.0
	2015	20.9	79.1	0.0
Housing	2005	0.0	100.0	0.0
	2015	0.0	100.0	0.0
Social exclusion	2005	3.8	96.2	0.0
	2015	2.7	97.3	0.0

Source: ESSPROS database

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