10/2015
FINNISH CENTRE FOR PENSIONS, REPORTS

EXECUTIVE SUMMARY

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Statutory pensions for the self-employed

– working life, confirmed income and financing

This report is an up-to-date review of central issues relating to the pension provision of the self-employed and entrepreneurs. It includes comprehensive information on pension insurance for the self-employed and important issues relating to the implementation of insurance under the Self-employed Persons' Pensions Act. In addition, the report offers information on the length of self-employed persons' working life and the level of the statutory pension for the self-employed. Finally, the report addresses the ratio of the earnings of self-employed persons to their confirmed income that acts as the basis for earnings-related pension.

This report consists of five independent articles. Each article reviews special issues and occasionally also different groups of individuals. What they all have in common is the insurance under the Self-employed Persons' Pensions Act, which is reviewed from many different angles. The first article provides a historical background for insurance of the self-employed. It also looks at pension as part of the overall social security for this group of people. The article also presents results of studies on the length of self-employed persons' working life, reviews recent changes in self-employment and discusses the confirmed income of the self-employed.

The following three articles depict how pension insurance for the self-employed is implemented. They also provide new data on characteristics of insured self-employed persons, the period of self-employment as part of the working life of the self-employed, the pension level and the confirmed income of the self-employed. The articles are based on the Finnish Centre for Pensions' overall data on insured persons. The research combines data on the self-employed used in the earnings- and national pension systems, by the pension providers and the Tax administration, as well as in the implementation of insurance for the self-employed.

The results apply mainly to the period 2010–2014 but, depending on the context, also to a longer period of time.

Confirmed income often set at lowest possible level

The second article of this report reviews central issues relating to the implementation of insurance under the Self-employed Persons' Pensions Act: the confirmed income, insurance and pension financing. The pension provider confirms the income that serves as the basis for the self-employed person's earnings-related pension. It should correspond to the work input of the self-employed. In 2014, the average confirmed income of the self-employed was EUR 23,100. An increase corresponding to the adjustment in the wage coefficient is done automatically to the confirmed income each year. The initial confirmed income of newly self-employed persons is usually set at some even figure, or at the lower limit of the insurance obligation or unemployment security. In the 2000s, the confirmed income has increased by 1.9 per cent per year in real terms. The confirmed income of women has risen slightly more than that of men.

The self-employed and entrepreneurs have been able to temporarily pay higher or lower earnings-related pension contributions (so-called flexible contribution payment) since 2005. The aim of the flexible contribution payment has been to raise the self-employed persons' confirmed income when it has been perceived as too low. In practice, very few self-employed persons – less than 0.5 per cent per year – have utilised the flexible contribution payment opportunity. Combined, the flexible contribution payment has increased the annual average total confirmed income by approximately 0.1–0.2 per cent, although it was more common to pay smaller contributions than to pay additional contributions in 2014. Paying additional earnings-related pension contributions has been slightly more common among the older self-employed and among those with a higher income from work. Paying smaller contributions is equally common in all income brackets.

Outlook of pension financing

The law reform of 2011, which extended the scope of people insured under the Self-employed Persons' Pensions Act, raised the average confirmed income of the self-employed by approximately three per cent in real terms compared with the previous year. The initial confirmed income of the newly self-employed rose by 45 per cent in 2011. As a result of the law reform, the higher confirmed income of the newly self-employed is explained by the fact that they had limited companies or corporations and that most of them already had a stable business and were not ordinary 'newly' self-employed.

The economic recession has caused the number of bankruptcy applications and distrained credits to increase. Despite this, the ratio of unpaid earnings-related pension insurance contributions to the premium income has been reduced in the last couple of decades. It seems that the economic situation of companies is better now than in the pre-recession 1990s. Of the

new insurance contributions due, approximately 2–3 per cent have been left unpaid in recent years. The ratio has declined slightly each year. Approximately 40–50 per cent of the unpaid contributions finally become statute-barred and are never collected. In due course, unpaid pension contributions will reduce the pensionable income. In recent years, the cut in income from work has amounted to approximately 1.5 per cent of the wage sum.

The development of the number of self-employed persons and the level of confirmed income will determine the direction of the near-future insurance premium income. From the point of view of financing, and compared to the wage-earners, the distorted age structure and the levels of confirmed income affect the insurance of the self-employed. Based on recent developments, the confirmed income levels are expected to grow moderately. Nevertheless, the raising of the lower earnings-limit entitling to unemployment security at the beginning of 2015 led to a higher average confirmed income level. In 2014, the State's share of the pension expenditure under the Self-employed Persons' Pensions Act was EUR 67 million. It will rise in the next few years.

Regardless of economic cycles, the pension expenditure under the Self-employed Persons' Pensions Act is under pressure to expand, mainly due to the growth in old-age pension expenditure. Simultaneously, the disability pension expenditure has decreased in recent years. According to the projections of the Finnish Centre for Pensions, the total pension expenditure will grow in the near future by approximately 3–4 per cent per year in real terms.

Self-employed on old-age pension after 39 years of working

The third article of this report looks at time spent in working life and time spent in retirement from various angles. The number of self-employed persons is growing slightly. By the end of the year 2014, approximately 206,900 persons were insured. That equalled 8.3 per cent of the labour force. People become self-employed at a later age than they become wage-earners. The average age of the self-employed is 46 years, exceeding that of wage-earners by five years. The self-employed are usually men: only one out of three is a woman. The self-employed are not particularly highly educated. The majority (65–67 per cent) of all self-employed and the newly self-employed has no more than a basic or a secondary level education. A high education level is rare both among the newly self-employed and those who have been self-employed for a longer time. Of all insured self-employed persons, 60 per cent have a secondary or lower education while only 10 per cent have a university degree. Women are more highly educated than men.

Surprisingly, the working life of the self-employed consists mainly of wage-earning work. In 2014, the median working life of persons retiring on an old-age pension was 38.8 years. Those with an intensive working life in self-employment (more than 80% of the working life insured under the Self-employed Persons' Pensions Act) have a median working life of 39.0 years. In practice, the working lives of those who have worked only as self-employed are about two years shorter.

Reasonable pension by combining paid work and self-employment

The same development trend is visible in the statutory pensions of the self-employed and entrepreneurs as in those of pension recipients in general. Certain early pensions are about to be abolished. Of all new retirees in 2014, 70 per cent retired on an old-age pension and 20 per cent on a disability pension. A low confirmed income combined with a short working life as a self-employed person means a small pension: the average monthly pension under the Self-employed Persons' Pensions Act in 2014 was EUR 414. The pension of a typical self-employed person includes, however, pension earned for paid work. In practice, the average monthly statutory pension based on the self-employed persons' own working life was EUR 1,270. This is approximately EUR 200 less than the average pension for all pension recipients.

Ratio of confirmed income to earnings

The fourth article deals with the self-employed persons' confirmed income in 2013. The research data covers approximately one third of all insured and established self-employed persons. According to the results, the confirmed income corresponds, on average, to an ample 70 per cent of the taxable earnings from self-employment. However, the variation is rather big, in particular in the lower income brackets. The result is consistent with the results of previous studies. On average, self-employed persons earn EUR 27,100 per year for their self-employment. The average confirmed income is EUR 18,700. The confirmed income relative to the earnings is 63 per cent for men and 79 per cent for women. Women's earnings are lower, but measured in euros, their confirmed income is slightly higher than men's. The ratio between the confirmed income and the earnings is the weaker the higher the earnings are. How long the self-employment has continued plays no greater role in the ratio of confirmed income to earnings.

Confirmed income seldom adjusted

When assessing the accuracy of the confirmed income level, it was evident that the self-employed are not very prone to adjust their initially confirmed income level. According to the fourth article, some self-employed leave their confirmed income unadjusted for years. Approximately one fourth has never adjusted their confirmed income during the validity period of the insurance.

Capital income rather insignificant

Capital income does not form a major source of income for the reviewed self-employed persons, who often represent traditional professions (e.g. hairdressers, physicians). In several fields, the total income of this group of self-employed persons consists completely of labour income, without significant capital income. On average, the role of capital income is somewhat bigger for self-employed persons with limited companies or corporations.

The Publication is available only in Finnish:
Yrittäjien lakisääteinen eläketurva – työurat, työtulot ja rahoitus. Eläketurvakeskuksen raportteja 10/2015.

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Ordering of publication:
www.etk.fi › Publications › Research publications › Reports › Statutory pensions for the self-employed: working life, confirmed income and financing
or aineistotilaukset@etk.fi

ISBN 978-951-691-231-1 (s-b)
ISBN 978-951-691-232-8 (PDF)

ISSN 1238-5948 (printed)
ISSN 1798-7490 (online)

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