

23

Eila Tuominen

**SELF-EMPLOYMENT AND PENSION
PROVISION FOR THE SELF-EMPLOYED
IN FINLAND**

1997



ELÄKETURVAKESKUS
PENSIONSSKYDDSCENTRALEN

Monisteita
Papers

Eila Tuominen

The Central Pension Security Institute, Finland

**SELF-EMPLOYMENT AND PENSION PROVISION
FOR THE SELF-EMPLOYED IN FINLAND**

Paper to the European regional meeting of International Social Security Association in Paris from 4 to 5 December 1997. "Social protection and the development of self-employment in non-agricultural occupations"

Eila Tuominen

Address:

The Central Pension Security Institute,
FIN-00065 Eläketurvakeskus, Finland

Phone: +358 - 9 - 1512159

Fax: +358 - 9 - 1512496

Email: eila.tuominen@etk.fi

CONTENTS

Introduction.....	5
Self-employment shows upward trend in Finland.....	5
Statutory pension plan for the self-employed in Finland.....	9
Government contribution to financing the pension plan for the self-employed.....	11
Economic crisis of the 1990s raised government share.....	12
Current changes in the pension plan for the self-employed...	13

SELF-EMPLOYMENT AND PENSION PROVISION FOR THE SELF-EMPLOYED IN FINLAND

Introduction

Information on the numbers of self-employed in Finland can mainly be derived from three sources: labour force statistics, population statistics and pension insurance statistics. Labour force statistics are based on a comprehensive sample study, whereas population and pension statistics are compiled from records. Tax data is a further source for details on the volume of self-employment in Finland. The figures representing the scale of self-employment differ somewhat according to source and data collection purposes.

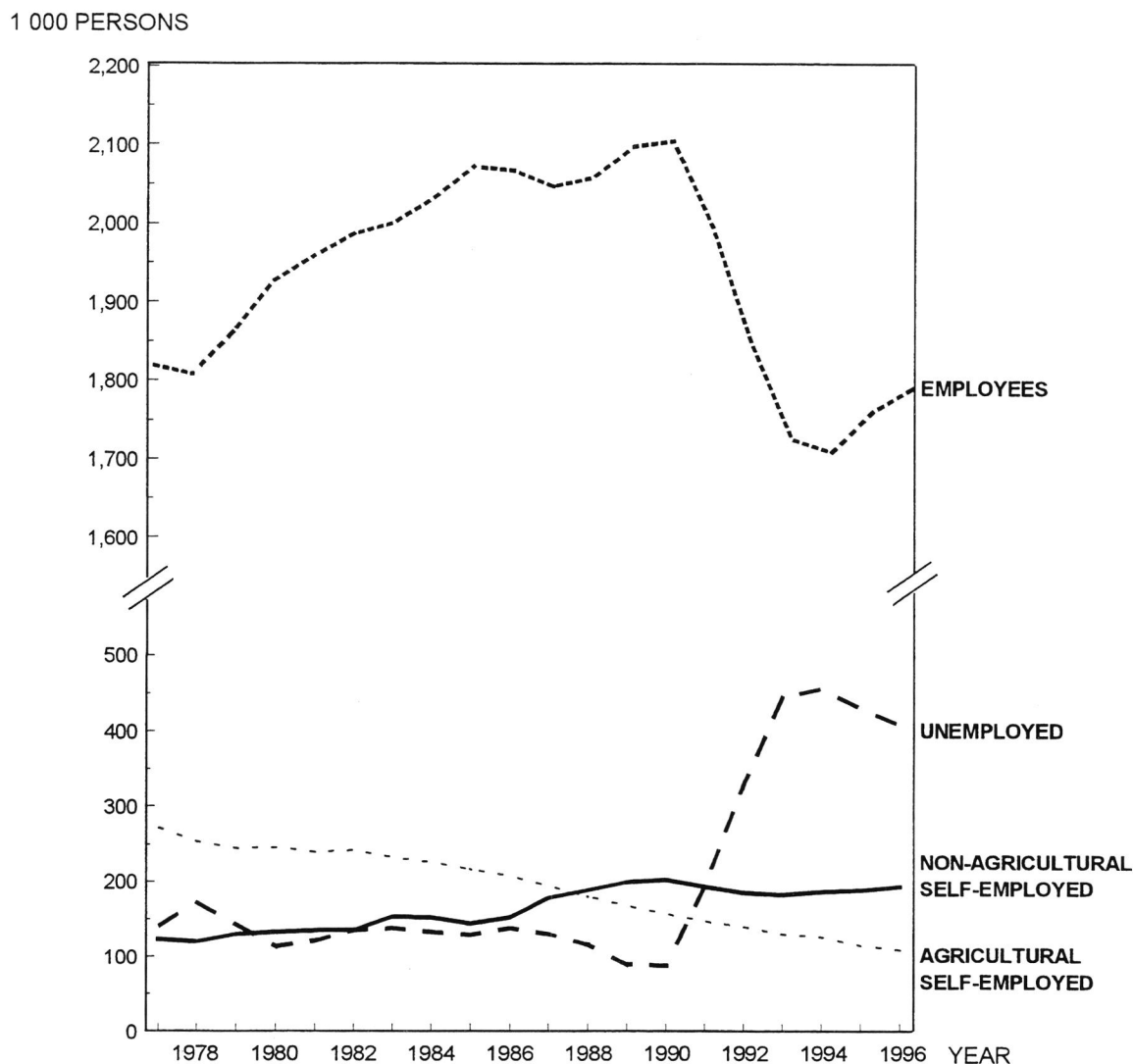
The following brief study discussing the development of the volume of self-employment in Finland is based on labour force statistics, in the context of which the self-employed are defined as encompassing employers and other self-employed people, including unpaid family workers. This group of people is covered by the statutory earnings-related pension plan for the self-employed, which is discussed later in this paper. Here the term self-employed is used to refer to self-employed people outside agriculture.

Self-employment shows upward trend in Finland

During the past few decades, the structure of the Finnish labour market has changed considerably. As shown by Figure 1, the number of employed persons increased for most of the past decade until the beginning of the 1990s. This growth was solely attributable to the rise in public sector employment. In the private sector, in contrast, the number of employed persons has displayed a slowly declining trend ever since the early 1980s, mainly because of the falling demand for labour in industry (Aho and Koski, 1995).

Likewise, the number of non-agricultural self-employed increased up to the turn of the decade, whereas the number of agricultural self-employed, i.e. farmers, has shown a tendency to decrease over the whole period under study. The expansion in the volume of self-employment was particularly concentrated to the latter half of the 1980s: between 1985 and 1990, the number of self-employed increased more than the number of employed persons, and the increase even exceeded net employment growth.

Figure 1. Employees, agricultural and non-agricultural self-employed and unpaid family workers, and unemployed people in 1977-1996, Finland



Source: Statistics Finland, Labour Force Survey (from different years)

In the wake of the economic crisis of the early 1990s, Finland witnessed an employment crisis, which caused the volume of salaried employment to collapse. In contrast, there was only a relatively minor decline in self-employment. Between 1990 and 1996, the size of the wage-earning population fell by a little over 300,000 persons, whereas the number of self-employed only declined by a little less than 10,000 persons over the same period.

The figures for the past few years reflect a clearly rising trend in employment in Finland, although we are still behind the rate of employment prevailing twenty years ago, where this study starts.

The proportion accounted for by the non-agricultural self-employed in the gainfully employed population has doubled during the period under study, from 5% in the early 1980s to 10% by the mid-1990s. This rise is attributable not only to changing patterns of employment but also to higher flexibility in production, a rising incidence of subcontracting, new forms of self-employment and new earnings opportunities. Many new businesses have been set up in recent years, but, on the other hand, close-down of businesses has also become more frequent in the 1990s. Growth has been most rapid in the field of corporate services (Aho and Koski, 1995).

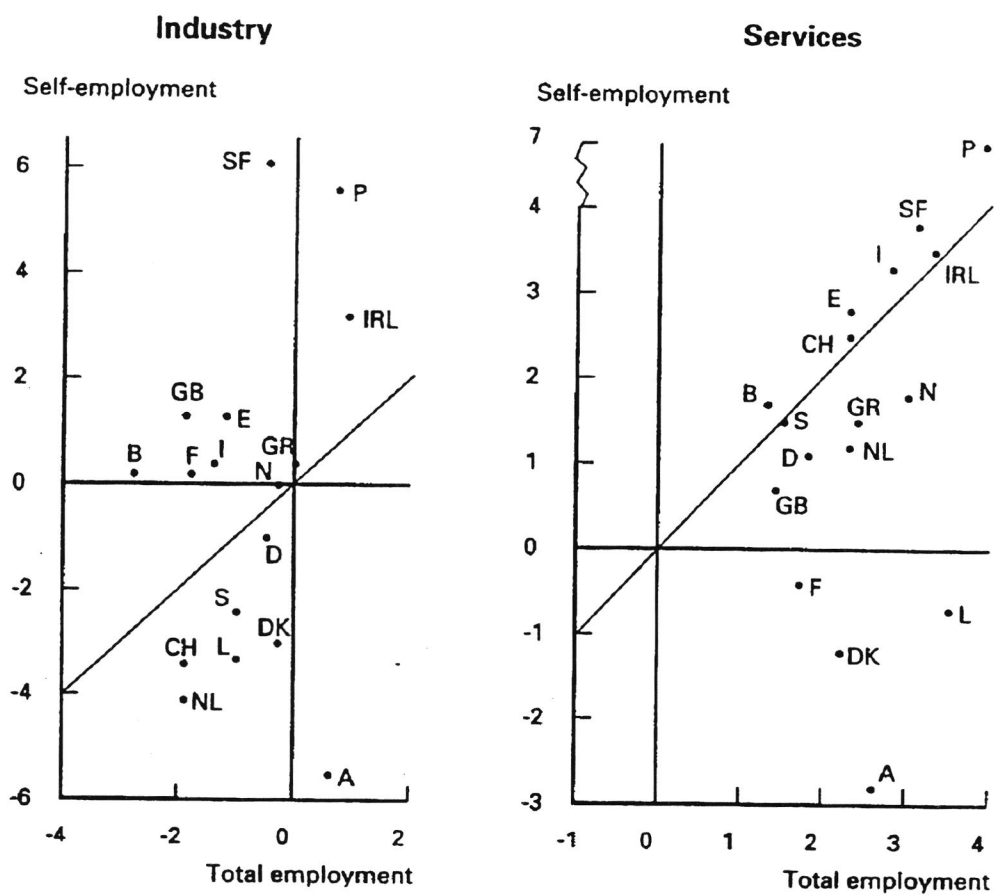
The rising trend in self-employment witnessed in Finland parallels developments in the rest of Europe: the volume of self-employment increased throughout the 1980s until the early 1990s, but growth has clearly slowed down in this decade (Employment in Europe 1993, 9 and 1996, 61). The growth stage in Europe is demonstrated by the enclosed Figure 2, which illustrates the changing patterns of total employment and self-employment in industry and services during the years 1977-1987. Despite the slight downturn in total employment within manufacturing experienced in most European countries in the period covered, there has been an increase in the volume of self-employment in many countries. In the light of this comparison, the upward trend in self-employment has been most pronounced in Finnish industry. The figure shows a rise in both self-employment and total employment in most European countries in the services sector during the period under study. In the services sector, too, the growth of self-employment has been one of the most rapid in Finland.

The pattern of self-employment did not change much in the former half of the 1990s. However, in the mid-1990s, there was an upturn in self-employment, which is also reflected in the figures for Finland. The proportion of non-agricultural self-employed in Finland currently represents almost the average of the EU member states (Employment in Europe 1996, 61, 147).

The prevalence of small businesses is very characteristic of self-employment both in Finland and in the rest of Europe. Statistics for 1992 uncover that 86% of the businesses of EU member states were micro businesses with 1-9 employees. The proportion is the same in Finland. Micro businesses employ a little less than one-fifth of the labour force in Finland; the corresponding EU average is one-quarter. (Statistics Finland, Enterprises 1997:3, 24).

In recent years, the proportion of small businesses has been on the increase in Finland. The hopes of a reversal in the trend in unemployment largely rest in self-employment and the growth of small and medium-sized businesses. There are currently several arrangements promoting self-employment and facilitating job creation practices. Government measures to support self-employment include the provision of employment assistance, or start-up grants, to unemployed persons who enter self-employment. During the past few years, such appropriations for starting a business have been considerably increased.

Figure 2. Annual growth of total and self-employment in industry and services, circa 1977-87 (%)



A	Austria	F	France	N	Norway
B	Belgium	GB	United Kingdom	NL	Netherlands
CH	Switzerland	GR	Greece	P	Portugal
D	Germany, F. R.	I	Italy	S	Sweden
DK	Denmark	IRL	Ireland	SF	Finland
E	Spain	L	Luxembourg		

Source: Loutfi 1991, 12 (ILO calculations)

Statutory pension plan for the self-employed in Finland

In Finland, the self-employed and the employed persons have, more or less, the same coverage for pension benefits. The self-employed are, on the one hand, covered by the residence-based national pension scheme and, on the other hand, by the earnings-related pension scheme. Coverage of the latter was extended to the self-employed on 1 January 1970 with the introduction of the Self-employed Persons' Pensions Act (YEL). Before this, the self-employed had almost always been solely dependent on the national pension for their income in retirement. The whole population became covered by the statutory earnings-related pension scheme in 1970, because the Farmers' Pensions Act (MYEL) was also passed at the same time. The corresponding pension acts for the employed workers in the private sector had already been introduced in the early 1960s (1 July 1962).

The Self-employed Persons' Pensions Act applies to those self-employed persons resident in Finland whose entrepreneurial activity does not earn them entitlement to pension under some other pension act or pension regulation. Members of the self-employed person's family are also regarded as self-employed within the meaning of the law, provided that they work in the business but do not have an employment contract with it. Coverage by the Act requires that the person is at least 18 years of age, that the entrepreneurial activity has lasted for at least 4 months and that the average monthly income exceeds the limit laid down in the Act (FIM 2,270.28 a month in 1997).

In other words, the Self-employed Persons' Pensions Act applies to those who are not covered by the Employees' Pensions Act. Demarcation of the boundary between self-employment and paid employment is often called for in determining which pension act shall be applicable to an individual insured person. In addition to businessmen, the Act covers professionals, such as doctors, lawyers, writers, and, for instance, freelance journalists. However, many jobs classified as atypical employment¹⁾ are on the borderline between paid employment and self-employment. With the increase in atypical employment, cases requiring demarcation of the boundary between paid employment and self-employment have become increasingly common.

The compulsory pension plan for the self-employed provides the same benefits as the corresponding employee pension plan, i.e. disability pension, individual early retirement pension, unemployment pension, part-time pension as well as old-age pension at 65 and the option of early old-age pension at 60. When a self-employed person dies, the spouse and children are entitled to survivors' pension, which is payable to both widows and widowers and to children.

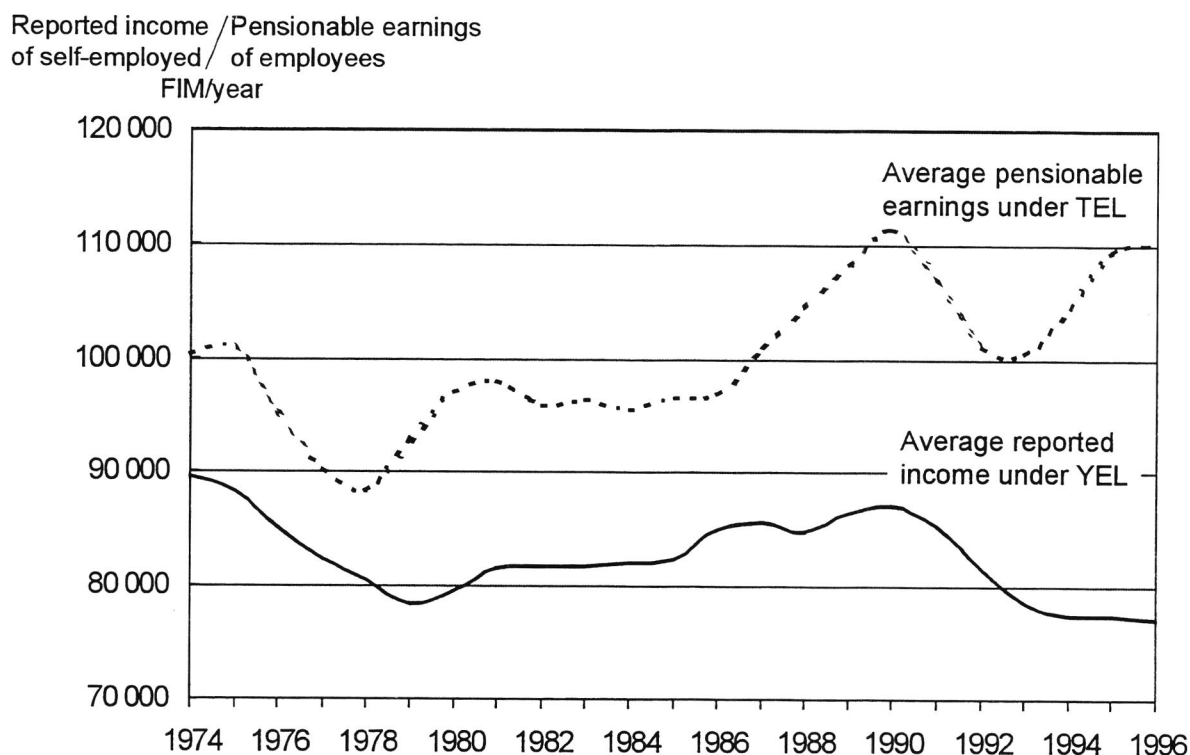
1) Most of the atypical work is work performed by employees with an employment contract, such as part-time and temporary work. Higher flexibility of production will, however, mean that regular employment is increasingly being replaced by outsourcing, subcontracting, homework and telework, and other types of atypical work.

The full earnings-related pension accrues in 40 years, and the pension starts to accrue at the age of 23. The targeted statutory old-age pension represents 60% of the income of the self-employed person, based on the average reported income for the whole career of self-employment. In co-operation with the organizations for the self-employed and with the pension institutions, the Central Pension Security Institute has prepared instructions for determination of the reported income. The reported income shall at least equal the salary that would reasonably be payable to someone with the same skills employed for the job of the self-employed person. However, the aim of the statutory pension plan is only to guarantee the self-employed person a reasonable income in retirement. Therefore, an upper ceiling has been set on the reported income covered by the insurance (for 1997 the ceiling was set at FIM 454,568 a year).

When a self-employed person takes out insurance under the Act for the first time, he has only started the business and may find it difficult to assess the income to be reported. Admittedly, a lower rate of contribution is payable on a small reported income, but a lower rate of contribution also gives a smaller pension. The idea is that the reported income once confirmed shall correspond to the value of the self-employed person's work contribution. When operations expand, the self-employed person shall have his reported income reassessed and adjusted in line with the change in the work contribution. Downward adjustment is also possible, for instance in a situation where the self-employed person starts to conduct the business on a part time basis. The reported income confirmed shall, however, be the permanent basis for the insurance.

Indeed, one of the problems encountered in pension provision for the self-employed is the widespread practice among the self-employed to set the reported income too low, especially when operations are started. As shown by Figure 3, the average reported income of a self-employed person is lower than the average pensionable earnings of persons employed in the small business sector. For this reason, the compulsory statutory pension of a self-employed person is lower than that of an employed worker. Examination of the earnings-related pensions granted in 1995 reveals that the average monthly pension payable to a self-employed person was FIM 3,000 and that payable to an employed person in the private sector FIM 3,600. Admittedly, there are also other reasons underlying these differences, such as the later maturation of the pension plan for the self-employed.

Figure 3. Average reported income of self-employed under YEL, and average pensionable earnings of employees under TEL in small businesses (under 50 employees), FIM/year (in the index of 1997)



Source: Mikko Pellinen, The Central Pension Security Institute.

Government contribution to financing the pension plan for the self-employed

When the pension plan for the self-employed was being designed, its architects were already aware that the unfavourable age distribution of the persons covered, as compared to the age distribution of employed persons, would place an additional burden on the pension plans for the self-employed and farmers. This is because people generally enter self-employment at a later age. For this reason, government contribution to financing pensions for the self-employed has been and continues to be necessary. In contrast, the pension plan for the employed persons in the private sector is financed by employers and employees alone, with no government contribution. Nothing has changed in the circumstances once justifying the contribution of government to financing pensions for the self-employed: the average age of those covered by the pension plan continues to be clearly higher than that of employed persons.

The government contribution is also necessary because of the legislative provision guaranteeing those born before 1 May 1930 a minimum pension level of 38%. The inclusion of this provision stems from the rules governing the maturity of the earnings-related pension scheme. Periods of self-employment before 1 January 1970 when the Act took effect do not count towards the pension. Accordingly, no contributions are collected for such periods.

In order to avoid an excessive rate of contribution for the self-employed, the Act provides that the rate of contribution payable by the self-employed shall represent the average rate of contribution payable for employed persons. This year the rate of contribution is 20.7%.

The pension plan for the self-employed is financed according to the pay-as-you-go method; in other words, the income for each year is used to cover the expenses incurred in the same year. Government has pledged to assume the expenses not covered by the contributions collected under YEL, including pension expenditure and administrative expenses. In the early years of the Act, part of the income was transferred to a fund. Very exceptionally, this also happened in 1990, when there was no need for government financing. In recent years, government contribution to financing pensions for the self-employed has been in the category of one-fifth.

The contribution of government to financing the pension plan for the self-employed is inclined to promote and encourage self-employment, which will also produce beneficial effects in terms of job creation.

Economic crisis of the 1990s raised government share

The economic crisis witnessed in the early 1990s came without a warning. It resulted in a marked increase in government liability for financing the pensions of the self-employed. In the years of the recession, the decline in the volume of insurance taken out by the self-employed has been faster than expected. Similarly, the self-employed have, in great numbers, filed applications for downward adjustment of the reported income laying the basis for contributions. Awards peaked in 1992-1993, when they accounted for 6-7% of the total volume of insurance. The average downward adjustment of the reported income ranged between 40 and 50%. Now that the Finnish economy has practically recovered from the depression, the self-employed should have their reported incomes adjusted accordingly.

In 1993, during the economic crisis, a legislative amendment was introduced to the effect of allowing self-employed people who were starting up a business a reduction in the rate of contribution. Self-employed people aged 43 or under are allowed a 50% reduction in the contributions payable for the first year and the two following years of business. A self-employed person may only receive the reduction once. In 1995, 29,000 persons received the reduction.

During the recession, cuts in indirect labour costs were made as a measure of supporting self-employment on a larger scale. In 1994, for instance, parliament took a decision to set the rate of contribution payable by farmers and self-employed persons lower than the legislated level.

In this decade, there has been a marked increase in government liability for the pension expenditure arising from the pension plan for the self-employed, which is ascribed to an increase in outstanding contributions. The bankruptcies and financial difficulties induced by the economic depression have resulted in failure to pay pension contributions among the self-employed. Whereas the sum of outstanding contributions with consequences for the government contribution represented FIM 407 million in 1990, the sum had more than doubled by the year 1996, representing FIM 831 million.

In 1996, for instance, around 15,000 out of a total number of roughly 155,000 self-employed persons insured for pension failed to make pension contributions. Pension institutions have to grant insurance under YEL to a self-employed person who qualifies for the insurance, irrespective of his financial standing. If the self-employed person fails to make pension contributions, the contributions are recorded as outstanding and measures for enforced collection of the contributions are initiated. Outstanding contributions remain so recorded for five years, whereafter they are registered as losses. According to the Ministry for Social Affairs and Health, around 10% of the contributions payable remain outstanding. Because of the increase in outstanding contributions, the government contribution is likely to grow during the next few years.

Current changes in the pension plan for the self-employed

The liability of the self-employed for financing their pensions will increase from the beginning of 1998 so that pension will start to accrue from paid contributions only. Parliament passed an act to this effect in November. Thus, failure to make contributions will result in a lower pension, so that the outstanding contributions under YEL payable for 1993 will be taken into account in the pension next year. After this, time-barred contributions are followed on an annual basis and recorded in the registers of the pension institutions. The pension of the self-employed will be reduced in proportion to outstanding contributions. The provisions governing enforced collection of contributions and the period of limitation will remain in force and the period will still be 5 years. The amendment applies to both farmers and other self-employed people.

The purpose of the reform is to improve the financial self-sufficiency of the pension plans for the self-employed and to reduce the need for government financing. In consequence of the reform, the expenditure under YEL is expected to fall, thereby generating savings, which for the year 2010, for instance, will be in the category of FIM 54 million.

One essential aim of the reform is also to disseminate more information to the self-employed on their liability to take out statutory pension insurance and on the merits of the statutory pension plan compared to private pension insurance.

The question whether the reduction in contributions allowed persons entering self-employment, should be made available to a larger number of self-employed persons was raised during the preparation of the legislative reform concerning plan financing. This would mean either raising the upper age for entitlement to the reduction or making the reduction available to all self-employed persons starting a business. Such a change could very well be justified by considerations of employment policy, because it would lower the threshold to self-employment for many elderly people. The prospects of changing the age limit will be explored in the near future.

Another reform of earnings-related pensions will also be introduced next year. The purpose of this reform is to make it easier for small businesses to attend to all their employer liabilities. In the first stage, the reform will simplify payment of pension contributions in businesses with fewer than 5 employees. Corresponding improvements and simplifications are also being designed for businesses with fewer than 10 employees.

The reforms designed are part of the government employment program, one purpose of which is to promote small businesses and to offer better prospects of self-employment in Finland.

References:

Aho Simo and Pasi Koski. Yrittäjyyden rakennemuutos ja kasvualat. (Self-employment, changing patterns and growth areas) Labour policy study No. 106, Ministry of Labour, Helsinki, 1995 (in Finnish)

Employment in Europe 1993, Commission of the European Communities, COM(93) 314.

Employment in Europe 1996, European Commission, COM(96) 485.

Loutfi, Martha F. Self-employment Patterns and Policy Issues in Europe. International Labour Review, Vol. 130, 1991, No. 1, 1-19.

Statistics Finland, SVT, Enterprises 1997:3. Helsinki 1997.



00065 ELÄKETURVAKESKUS
Puh. 09 - 1511 Faksi 09 - 151 2496

00065 PENSIONSSKYDDSCENTRALEN
Tfn (09) 15 11 Fax (09) 151 2496

FIN - 00065 ELÄKETURVAKESKUS
Finland
Tel. +358 - 9 - 1511, Fax +358 -9 - 151 2496

Eläketurvakeskus on Suomen työeläkejärjestelmän lakisääteinen keskuslaitos. Sen tutkimustoiminta koostuu pääasiassa sosiaaliturvaan ja eläkejärjestelmiin liittyvistä aiheista. Tutkimuksissa pyritään monipuolisesti ottamaan huomioon sosiaalipoliittiset, sosiologiset ja taloudelliset näkökulmat.

Pensionsskyddscentralen är lagstadgat centralorgan för arbetspensionssystemet i Finland. Forskningsverksamheten koncentrerar sig i huvudsak på den sociala tryggheten och på de olika pensionssystemen. Målet för forskningsprojekten är att mångsidigt belysa aspekter inom socialpolitik, sociologi och ekonomi.



The Central Pension Security Institute is the statutory central body of the Finnish employment pension scheme. Its research activities mainly cover the fields of social security and pension schemes. The studies aim to paint a comprehensive picture of the sociopolitical, sociological and financial aspects involved.

ISSN 1238 - 4984