

Finland reforms the income basis for calculating pension insurance contributions for the self-employed

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The Finnish government will reform the income basis for calculating pension insurance contributions for the self-employed. Currently, the self-employed themselves can decide the income they will insure. Oftentimes, they choose the lowest contribution category, which leads to low earnings-related pensions. Furthermore, income chosen for pension contribution purposes has ramifications for other income transfers as well. For example, sickness and family leave benefits are calculated on the basis of pension-giving income. The reform will be effective from 1 January 2023.

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Description

In Finland, pension insurance is mandatory for the self-employed in the age bracket 17 to 67 years whose self-employment has continued for 4 months, and whose annual income exceeds the minimum annual threshold (€8,261.71 in 2022). In principle, the pension scheme for the self-employed (Yrittäjän eläkevakuutus, YEL) guarantees exactly the same pension rights as the pension scheme for employees. The annual accrual rates (1.5%) are the same as for employees. The YEL contribution rates vary (from 24.1% to 25.6%), depending on the age of the self-employed person. In contrast to employees, the self-employed can choose their confirmed income for contributions that in turn defines the level of their future pension. Oftentimes, self-employed persons choose the minimum level of pension contributions, i.e. they under-insure themselves. Consequently, their earnings-related pensions lag behind those of employees, and are not necessarily significantly higher than the level of the Guarantee Pension. In addition, the confirmed income determines the level of other income transfers, such as sickness daily allowances and parental benefits, that therefore also remain at the minimum level when the minimum level of pension contributions is chosen.

In 2019, when evaluating the adequacy of pensions for the self-employed, the OECD (2019) recommended that Finland should reform the basis of the pension contributions for the self-employed. Instead of self-declared income, the pension contributions should be linked to

actual income, or pension institutions should better monitor whether the self-employed are setting the contribution base much lower than their actual income.

In its governmental programme, Sanna Marin's centre-left government (appointed 10 December 2019) put the reform on its to-do list and stated that "different models for improving the social security and pension security of entrepreneurs and the self-employed will be reviewed" (Government of Finland, 2019). On 16 June 2022, the government presented a bill (HE102/2022) on the reform to parliament.

According to the bill, the confirmed income for the self-employed should be estimated using the median wage of private-sector employees in the industry in question as a starting point for determining the insurable earnings. Indeed, in future, the pension institution will evaluate the self-employed person's income for pension contribution purposes on the basis of the wage that should reasonably be paid if a person with similar professional skills had to be hired to perform entrepreneurial activities. However, the pension institution must take into account all other relevant information on the amount of work performed by the self-employed person.



Outlook and commentary

The overarching goal of the new legislation is to improve the pension security of the self-employed and ensure that the confirmed income used for defining the contributions better reflects the value of the work done. Due to underinsured income, the median pension of the self-employed in 2018 was 20% lower than the

median pension for employees (OECD, 2019).

In their commentaries, representatives of the self-employed have expressed mixed opinions on the initiative. Yrittäjät, the interest and service organisation for self-employed and small and medium-sized enterprises in all fields of economic activity in Finland, has welcomed the initiative to improve social security for the self-employed. However, Yrittäjät (2022) is concerned about the rationale behind the proposal and is calling for the law to be amended so that the median salary is not applied mechanically, and to ensure that special features of the industry in question are taken into consideration. Yrittäjät also emphasises that only the self-employed themselves can provide credible evidence about the amount of work they have provided. The risk is that the reform may increase the financial burden for many self-employed people.

The Union of Journalists and the organisation representing Freelance Journalists have expressed their concerns about that risk (Heinilä and Nieminen, 2022). They criticise the bill for not focusing on the areas in which the

earnings of the self-employed are significantly lower than those of employees in similar work. For example, the average earnings of a self-employed journalist are only half that of an employed journalist. According to them, the proposed change would lead to significant increases in pension contributions and, in the worst scenario, business closures and unemployment. They emphasise that freelancers are not able to raise their prices because the bargaining power of an individual freelancer relative to large media houses is weak. According to them, the proposed reform would be a significant weakening of the position of all freelancers.

Interestingly, there seems to be a conflict between two aspects of justice. Whereas the Marin government uses the "formal" principle of justice, i.e. all similar cases should be treated similarly, the critics of the bill use the "substantive" principle of justice, and emphasise that unlike cases must be treated in differential ways. The political debates in the autumn of 2022 will clarify the substantive principle of justice and determine which cases are counted as like and which as unlike in the case of pension insurance contributions for the self-employed.

Further reading

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