

## Self-Employed Ones Deserve a Pension Too! The Regulation Background of the Pension Savings for the Self-Employed Persons in Latvia\*

Evija Dundure<sup>1</sup>

<sup>1</sup>University of Latvia, Dundure.Evija@gmail.com, ORCID: <https://orcid.org/0000-0002-2114-2564>

**Abstract:** Once countries with the pension system construction based on the three pillars – compulsory and voluntary – are considered, the expected income after retirement for the wage earners should be on the adequate level. Nevertheless, it needs to also be taken into the consideration that there are other categories, such as self-employed persons, royalties receivers, small business owners and the employees of special regime tax-paying companies (further in the text – self-employed persons). These individuals have limited access to the state guaranteed pension (1st pillar) and employer-based supplementary pension schemes (2nd pillar). Consequently, they must rely on private pension savings (better known as the “third-pillar”). In addition, the governments of different countries carry out diverse tax-policies, especially for low earnings receivers. The aim of this paper is to analyze the pension system for self-employed persons in Latvia and enlighten possible scenarios of savings for income after retirement. The study is based on analysis of legislative documents, and comparisons of legislative norms, calculations of a functional relationship and regression analyses. Although the Latvian government’s awareness of current situation results in attempts to maximize the pension income level, the results of this paper highlight the exceptional situation of self-employed persons in Latvia in comparison with the employed ones. The growing trend of number of self-employed persons in Latvia enlightens the necessity for the improvements of regulations to provide pensions on adequate level.

**Keywords:** Pensions system, voluntary savings, governments, regulations, self-employed.

### 1. INTRODUCTION

Population self-employment has recently become one of the issues discussed in the field of employment both at the global and national levels. The general trend in developed countries is a long-term decline in the share of self-employed (OECD, 2019). This tendency can be explained by technological change experienced during the last century favoring capital-intensive and large-scale production (Fairlie and Meyerm, 2000) as well as the national governments' initiative to separate so-called economically "dependent" self-employed and false self-employment from real ones.

The national regulations and habits of the self-employed to save for old age have attracted the attention of researchers. Since social guarantees for the self-employed usually differ from which of the employee package, the approach of the self-employed in the formation of pension capital is studied - what institutional opportunities are used and to what extent (Choi, 2009; Schulze Buschoff and Schmidt, 2009; Mastrogiacomo and Alessie, 2015). In 1996 researcher Taylor (1996) answers the question of why people are choosing self-employment status: "because of higher expected earnings relative to paid employment and by the freedom from managerial constraints that it offers." Later on, social scientists try to make sure that the self-employed have chosen this status because the autonomy in their decisions and willingness to take

risks themselves and usually do not find confirmation of this assumption (Dekker, 2010; Fachinger and Frankus, 2015).

Moreover, it is clear that although many self-employed people try to save for old age, there are too many who have virtually no savings (Thaler and Benartzi, 2004). According to Hatfield (2015), in the research about self-employment in Europe, it is stated that "self-employed workers are less likely to have made contributions to a private pension scheme: in 2010/11, only 21 percent had done so, compared to 50 percent of employees".

Besides, Conen et al. (2016) had defined in the analysis of three types of self-employed based on their level of financial stability and social protection. As a result, all respondents were divided into " 'precariously solo self-employed' (12.6%), solo self-employed who 'get by' (43.7 %) and 'self-sufficient' solo self-employed (43.8%)", with particular emphasis on the need for changes in government social policy to improve social security of self-employed.

The question arises - what has happened in recent decades to change the motives of self-employment so drastically? One of the answers could be found in the research provided by Hershey et al. (2017) about Germany and the Netherlands by distinguishing two types of self-employment: forced and voluntary. The analysis of the nature of self-employment – whether it was forced or voluntary showed that forced self-employed persons were

---

\* The paper is supported by the National Research Programme in Latvia INTERFRAME-LV.

not as willing to take care of their pension savings themselves as voluntary self-employed people were able to do. An additional reason for changes is that self-employment has been moved from recently low self-employment industries, such as manufacturing, toward high self-employment industries, such as construction, consultancy, and business and repair services with a much higher competition level (Fairlie and Meyer, 2000).

In Latvia self-employment has become one of the permanent kinds of employment, for some categories of professions, even lifelong. Therefore national government should create a sustainable social protection system. There are suggestions from government institutions (The State Labour Inspectorate of Latvia, 2018) to rely on private pension savings in “third pension pillar” companies since self-employed have limited access to the state-guaranteed pension (1st pillar) and compulsory supplementary pension schemes in privat funds (2nd pillar).

The aim of this paper is to analyze the pension system for self-employed persons in Latvia and enlighten possible scenarios of savings for income after retirement. The study is based on analysis of legislative documents, academic research and comparisons of legislative norms, regression analyses and calculations of a functional relationship, regulating social security for pensions of self-employed in Latvia.

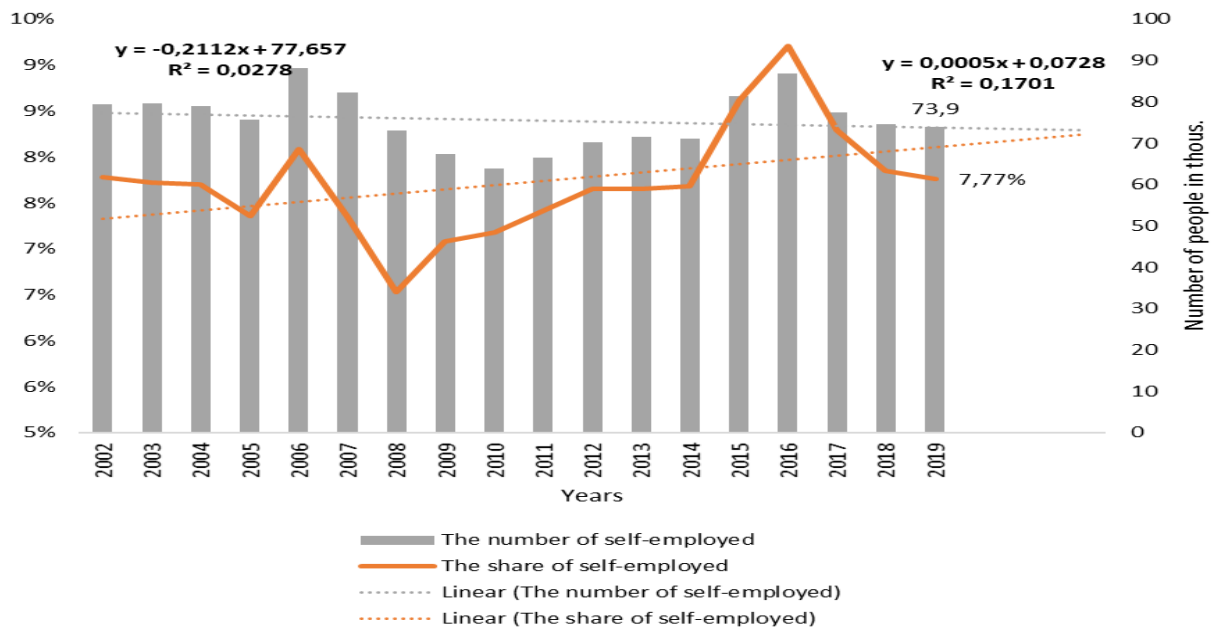
## 2. MATERIAL AND METHODS

After regaining independence and introducing the principles of a market economy in 1990, the field of employment in Latvia was remarkably transformed. In parallel with the classical form of employment in employee status, those employed in agriculture and fishing, sworn notaries, lawyers, and auditors, general practitioners, pharmacists, and veterinarians, as well as other natural persons who earn income in their economic activity became relevant (Saeima, 1993). The government institutions and researchers have found Latvia's dual situation.

On the one hand, recent technological developments, demographic trends, and changes in labor markets, as well as workers' desire for greater autonomy and self-determination in the organization of work, leads to a higher level of self-employment (Valsts Darba Inspekcija, 2018). On the other hand, national initiatives aim to reduce the shadow economy and, thus, false self-employment (Putniņš and Sauka, 2011).

As a result of the influence of these two factors and reduction of employed people in Latvia, the total number of self-employed persons in Latvia has decreased. At the end of 2019, there were almost 74 thousand (~8% from all employment) self-employed persons in Latvia ([www.csb.gov.lv](http://www.csb.gov.lv)). Linear trendline (Figure 1) indicates that number of self-employed in Latvia reduces annually in average by 0,21 thousand persons with coefficient of determination  $R^2 = 0,0278$ . The share of self-employed in 2019 was 7,8% which is the same as it was in 2002, however the trendline shows slightly growing tendency with trend coefficient 0,0005 and coefficient of determination  $R^2 = 0,1701$ .

Figure 1. Trendline of number and share of self-employed persons in Latvia from 2002-2019



Source: Elaborated by the author based on Central Statistical Bureau of Latvia "Data on employed by status and sex", retrieved from [www.csb.gov.lv](http://www.csb.gov.lv) on 20.08.2020

In contrast, the number of self-employed persons registered as taxpayers during last eight years has increased from 11 thousand persons in 2012 till 29 thousand persons in 2019. Data in taxpayers register indicate that less than half of self-employed persons are paying taxes including contributions in social security in Latvia ([www.csb.gov.lv](http://www.csb.gov.lv), [www.vid.gov.lv](http://www.vid.gov.lv)).

According to the research provided on behalf of the Latvian government institution "The State Labour Inspectorate" (2018), an essential factor that may negatively affect the quality of life of the self-employed in various social risk situations and material well-being in the future is that a part of the self-employed avoids making mandatory contributions in social security or makes them from the minimum amount of compulsory contributions. There is a low motivation among the self-employed to pay taxes, as well as a lack of awareness and understanding of the importance of making compulsory contributions and social security in old age. A significant part of the self-employed considers that the payment of mandatory contributions is not essential for receiving various social insurance services and is not aware that the amount of the calculated social service depends on the compulsory contributions made. However, about 40% of respondents are going to rely on the state-guaranteed pension based on their social tax payments, while only 23% of interviewed self-employed persons were participating in the private pension funds for the 3rd pension level.

## 2.1. Self-employment social security regulations

The current legal regulation of all non-traditional forms of employment in Latvia is determined by the Law "On Personal Income Tax" and Law "On State Social Insurance" (Saeima, 1997; Saeima, 1993). According to them, self-employed is a person who earns income as:

- a person whose permanent residence is in the Republic of Latvia and who receives royalties (remuneration of copyright and related rights), except for the heir of copyright and other successors in title,
- sworn notary,
- Attorney at Law,
- sworn auditor,
- medical practitioner, medical pharmacist, veterinary surgeon, practical optometrist,
- the owner of a farm (fisherman's) who, not having an employment relationship with the management institution of his / her farmer (fisherman's) farm, performs the management function of this farmer (fisherman's) farm, if no manager has been appointed (elected) to this farmer (fisherman's) farm in accordance with Law (director),

- a person whose permanent residence is in the Republic of Latvia and whose work is paid for from the funds of foreign technical assistance or loans of international financial institutions granted to the Republic of Latvia,
- Bailiff,
- sole proprietor, including a sole proprietor who drives a vehicle in commercial passenger transport by taxi or car,
- another natural person whose permanent residence is in the Republic of Latvia and who is registered as a payer of income tax obtained in economic activity.

The Law "On Regulated Professions and Recognition of Professional Qualifications" (Saeima, 2001) provides a more precise definition. It stipulates that a self-employed person is a person who earns income independently without engaging in employment as an employee and not holding a job position that entitles him or her to remuneration.

The self-employed in Latvia can choose one of several tax payment regimes with different Personal Income Tax and Social Contribution rates (Saeima, 1993; Cabinet of Ministers of Latvia; 2017): taxed from income from economic activity; patent fees; royalties and micro-enterprise tax, Table 1.

There is no official open-access statistical information on how in Latvia the self-employed are divided into tax payment regimes. However, given that the most recently introduced and in the author's view, the most applicable is the form of income from economic operations. Therefore, the future study is limited to focusing on pension-based scenarios for self-employed persons who are registered as taxpayers of revenue obtained in economic activity (further in text – self-employed).

Self-employed in Latvia has the opportunity to pay social tax according to two scenarios:

1. As a general rule, paying 32.15% of income, of which 24.5% is for pension insurance;
2. Paying a special rate of 5% for pension insurance. This is paid from all income, in addition to the contributions made following the general procedure, at least from the minimum wage (in 2020, the minimum wage was 430 euros).

All the self-employed persons can join pension insurance voluntarily by making a 24.50% contribution from a voluntary contribution facility (Cabinet of Ministers of Latvia; 2017). Of the social payments paid to the state for pension insurance, 81.6% of the contributions are transferred to the pension savings account of a particular person. The rest paid is a solidarity payment for the maintenance of specific types of pensions in the state.

Table 1: Regulation and rate of compulsory income tax and social tax contributions in 2020 in Latvia

Tax Payment Mode	The tax rate on economic activities	Social security regulation	The compulsory contribution rate for social security
Income from Economic Activity	20%/23%/31,4%	<ul style="list-style-type: none"> <li>- Contributions do not have to be paid if income in the tax year &lt; 50 euros.</li> <li>- Contributions are paid only 5% for pension insurance if income &lt; 430 euros per month.</li> <li>- Contributions must be paid in the general order from a freely chosen facility of not less than EUR 430, if the income is ≥ 430 euros per month. Of the difference between revenue and freely chosen object, contributions of 5% to pension insurance.</li> </ul>	32.15% (of which 24.5% for pension insurance) + 5% Pension insurance
Patent fee	50 – 100 euros	67% of the paid patent fee is credited to the compulsory deposit account. The object of compulsory contributions is determined based on the minimum contribution rate.	26.38% (of which 24.5% for pension insurance)

Royalties	20%/23%/31,4%	Contributions shall be paid if: (1) royalties ≥ 430 euros per month. 2) the beneficiary of the royalty is not a worker or working salary < 430 euros per month.	32.15% (of which 24.5% for pension insurance)  + 5% pension insurance
Micro-enterprise taxpayer	15%	80% of the micro tax paid is credited to the compulsory deposit account of social insurance	34,09% (of which 24.5% for pension insurance)

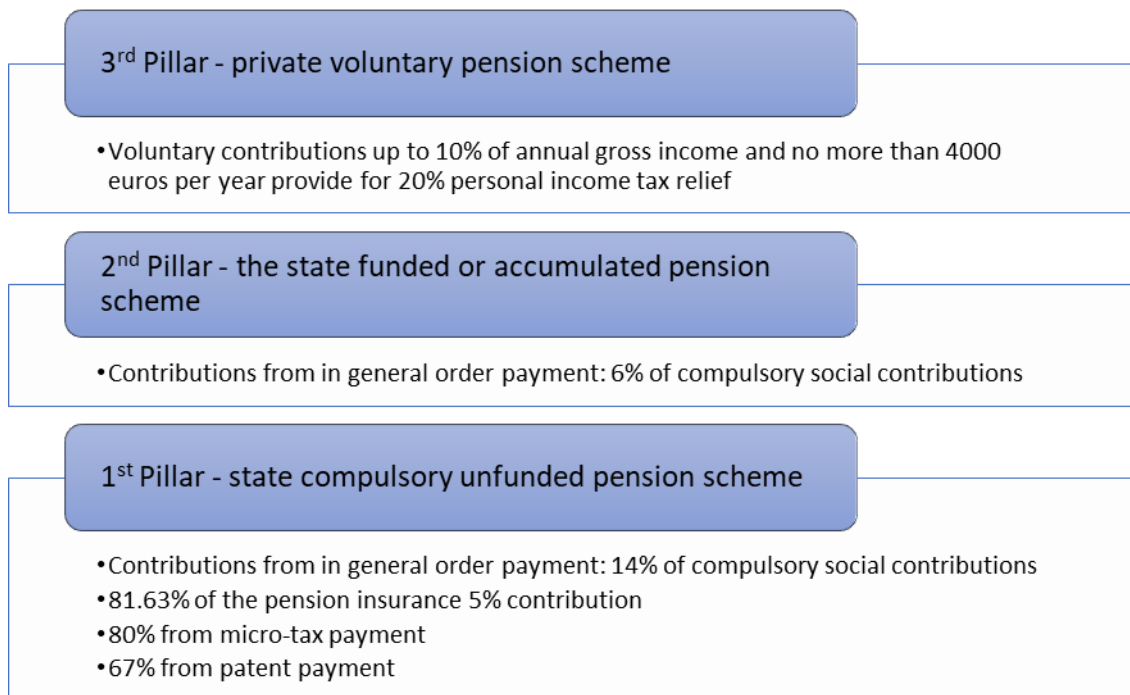
Source: Elaborated by the author based on The State Labour Inspectorate of Latvia (2018); Regulations of the Cabinet of Ministers of Latvia (2017).

## 2.2. Pension system regulations

The pension system in Latvia, like in the majority of world countries, is constructed based on three parts or so-called "three pension pillars": 1<sup>st</sup> Pillar - state compulsory unfunded pension scheme, 2<sup>nd</sup> Pillar - the state-funded or accumulated pension scheme and 3<sup>rd</sup> Pillar - private voluntary pension scheme. Legislation regulations of the Pension and Tax system in Latvia since 1991 (with a new law in 1996) provide for the possibility to redirect mandatory social tax payments to the 1st pension pillar. In turn, Figure 2. Pension system and contributions of self-employed in each Pension Pillar in 2020 in Latvia

since 2001, part of the social tax payment goes to the 2nd level of pensions - funded pension plans. Although opportunities to create savings at the 3rd pension level have existed since 1998, in 2018, only ~ 17% of the active population of Latvia had voluntary pension savings (Dundure, Sloka, 2020).

Self-employed, according to the chosen Tax Payment Mode (Figure 2) have a different structure of contributions to the social system and, thus, also their pension savings.



Source: Elaborated by the author based on Regulations of the Cabinet of Ministers of Latvia (2017) and Law personal income tax" (Saeima, 1993) and data from www.manpensija.lv

"On

When registering in one of the tax-payment modes, the self-employed have the opportunity to pay social contributions for pension insurance at the 1st and 2nd pension level in full, choosing the social contributions determined following the general procedure voluntarily. According to a study organized by the "The State Labour Inspectorate" (2018), most of the registered self-employed have chosen tax payment methods with the lowest contribution rates: patent fee, micro-tax or the status of an economic worker with minimum contributions.

### 3. RESULTS AND DISCUSSION

The analysis of the social insurance tax system of self-employed persons in Latvia demonstrates the government's efforts to find an acceptable tax regime for each category of population. The aim of the government has been to involve the population as much as possible in the registration of their economic activities and the payment of taxes. To achieve this goal, preferential and reduced tax regimes have been established, which are usually either a percentage or a single fixed payment determined by the state, which includes personal income tax and mandatory state social insurance contributions for the economic activity of a natural person.

The very first such special tax regime was introduced as a result of the Great Crises in 2010 (Saeima, 2010), setting a 9% tax calculated on turnover. Till 2020, this tax regime is significantly limited to specific professions and increased to 15%.

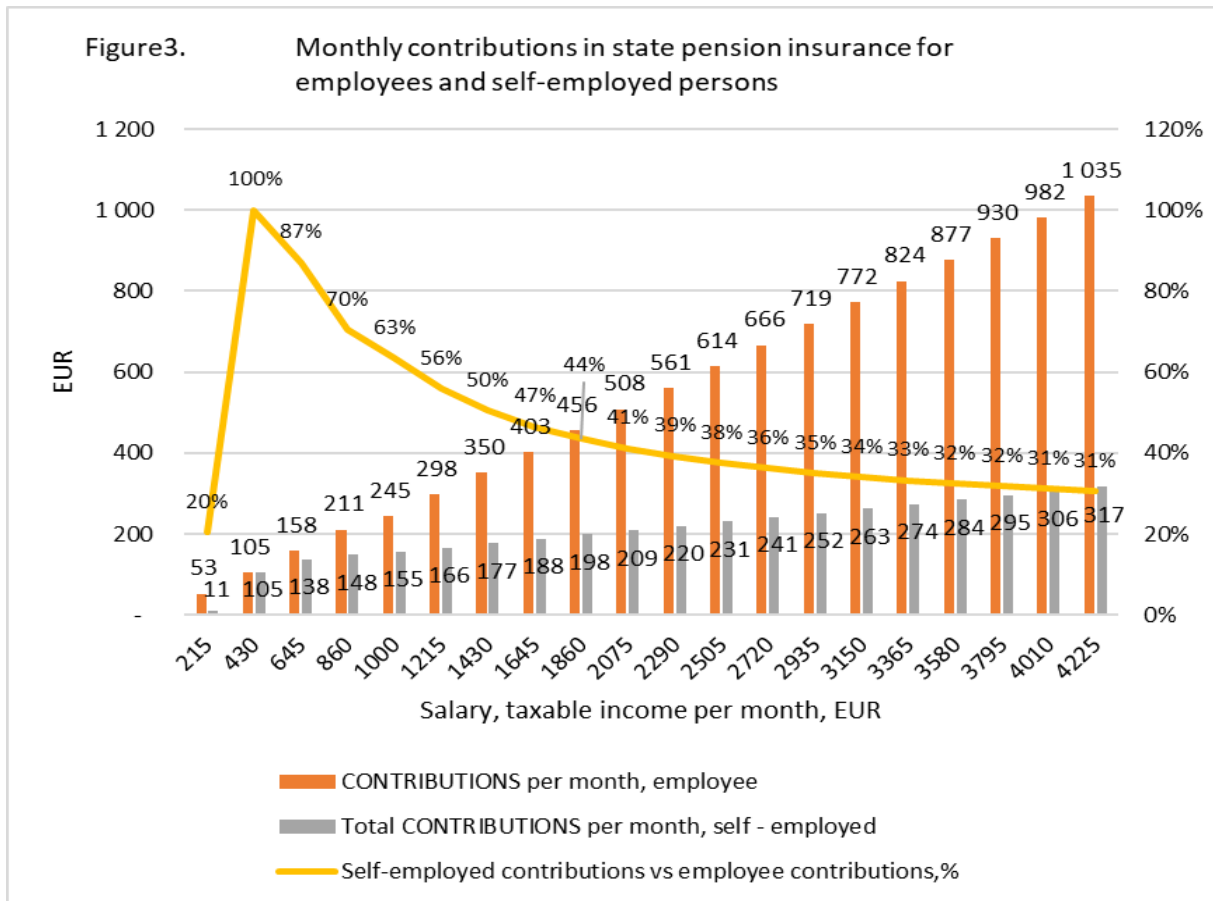
One of the last specific taxes introduced in Latvia is the patent fee, which was introduced only in 2010 and is intended for such professions as beauty care specialists, craftsmen, housekeepers, seamstresses, masseurs, florists and others.

In Latvian society, the debate about the weak social security for special taxpayers is not calming down - starting with unemployment risks, sickness benefits, job security and not counting on the amount of the expected pension. The Latvian Government Action Plan (Cabinet of Ministers of Latvia, 2019) sets out the action plan measure "Evaluate the performance of mandatory state social insurance contributions for the self-employed". One thing is clear, because low-tax non-payers are also the people with the lowest incomes, and therefore also the lowest-earning assets, and they are also the most socially vulnerable part of the population.

Therefore, the primary task of self-employed tax-system in Latvia has been to engage the socially unprotected people into registered operations. The most effective way to do this is to set up a minimum, easy-to-administer tax system that provides basic social security for those who have not paid taxes so far. For self-employed persons with the tax-payment mode No1 (Table 1) after registering their economic activity the burden of Social insurance tax for mandatory pension savings is significantly lower than the tax burden on employees.

Figure 3 presents the monthly amount of pension insurance tax payments for self-employed and employees in Latvia on 2020.





Source: Elaborated by the author based on Regulations of the Cabinet of Ministers of Latvia (2017) and Law "On personal income tax" (Saeima, 1993)

It has been clearly shown that up to the level of the minimum wage (430 EUR), the self-employed are less protected than employees, as only 5% of income has to be paid, of which 80% goes to the 1st pension level. When receiving income or a salary in the amount of the minimum wage, the pension insurance payments for both categories are equal, they are 105 euros per month.

On the other hand, as income increases and the self-employed choose to pay the minimum allowed tax rate, the difference in pension payments between

they will have a wealthy old age, the reality may be different. Employees will have paid higher amounts and will also receive more, while the self-employed with minimum contributions will receive a minimum level of old-age pension, thus placing them at risk of poverty.

**REFERENCES**

Cabinet of Ministers of Latvia (2017) Ministru kabineta 2017. gada 19. decembra noteikumi Nr. 786 "Noteikumi par valsts sociālās apdrošināšanas iemaksu likmes sadalījumu pa valsts sociālās apdrošināšanas veidiem" (Regulations on the Distribution of the State

the self-employed and employees is growing rapidly. Receiving an income of 1505 euros per month, the self-employed pay only 49% of the employee's taxes on pension insurance, with an income 4300 euros per months the proportion would be only 30%.

It is expected that the provisions for old-age pensions will differ to the same extent for both categories of the population. Although both have followed national tax regimes and lived with people's usual confidence in the government that

Social Insurance Contribution Rate by Types of State Social Insurance)

Cabinet of Ministers of Latvia (2019) Ministru kabineta rīkojums Nr. 210, Rīgā 2019. gada 7. maijā, prot. Nr. 21 27. § " On the Government Action Plan for the Implementation of the Declaration of the Intended Activities of the Cabinet of Ministers Led by Arturs Krišjānis Kariņš"

Central Statistical Bureau of Latvia. (2020)., Data on employed by status and sex, retrieved from www.csb.gov.lv on 20.08.2020

Choi, J. (2009). Pension Schemes for the Self-Employed in OECD Countries. OECD Social, Employment and

- Migration Working Papers, No. 84, OECD Publishing, Paris.
- Conen W., Schippers J., Buschoff, K. S. (2016). Self-employed without personnel: Between freedom and insecurity. Utrecht, Netherlands : Utrecht School of Economics, Utrecht University.
- Dekker, F. (2010). Self-Employed without Employees: Managing Risks in Modern Capitalism. *Politics & Policy*, 38(4), 765–788.
- Douglas A. Hershey, Hendrik P. van Dalen, Wieteke Conen, Kène Henkens (2017). Are “Voluntary” Self-Employed Better Prepared for Retirement Than “Forced” Self-Employed?, *Work, Aging and Retirement*, 3(3), 243–256.
- Dundure, E., Sloka, B. Government incentives for the 3rd pension pillar in Latvia, The 78th International Scientific Conference of the University of Latvia “Challenges and Solutions of the Latvian State and Society in the International Context”, 10th of March 2020
- Fachinger, U., Frankus, A. (2015). Freelancers, self-employment and the insurance against social risks. In A. Burke (ed.), *The handbook of research on freelancing and self-employment* (pp. 135–146). Dublin, Ireland: Senate Hall Publishing.
- Fairlie, R., Meyer, D. (2000). Trends in self-employment among white and black men during the twentieth century, *Journal of Human Resources*, 35, 643–69.
- Fairlie, R. and Meyer, D. (2000). Trends in self-employment among white and black men during the twentieth century, *Journal of Human Resources*, 35, 643–69.
- Hatfield, I. (2015). *Self-employment in Europe*. London, UK: Institute for Public Policy Research.
- Mastrogiacomo, M., Alessie, R. J. (2015). Where are the Retirement Savings of Self-Employed? An Analysis of ‘Unconventional’ Retirement Accounts. DNB Working Papers 454. Amsterdam: Netherlands Central Bank.
- OECD (2019). *OECD Employment Outlook 2019: The Future of Work*, OECD Publishing, Paris
- Putniņš, T. J., Sauka, A. (2011). Size and determinants of shadow economies in the Baltic States, *Baltic Journal of Economics*, 11 (2), 5-25.
- Saeima (Parliament of Republic of Latvia). (2001) "Par reglamentētajām profesijām un profesionālās kvalifikācijas atzīšanu". *Latvijas Vēstnesis*, 105.
- Saeima (Parliament of Republic of Latvia). (2010) Mikrouzņēmumu nodokļa likums. *Latvijas Vēstnesis*, 131, 19.08.2010.
- Saeima (Parliament of Republic of Latvia). (1993) Likums "Par iedzīvotāju ienākuma nodokli". *Latvijas Vēstnesis*, 32.
- Saeima (Parliament of Republic of Latvia). (1993). Likums "Par iedzīvotāju ienākuma nodokli". *Latvijas Vēstnesis*, 32.
- Saeima (Parliament of Republic of Latvia). (1997) Likums "Par valsts sociālo apdrošināšanu". *Latvijas Vēstnesis*, 274/276.
- Schulze Buschoff, K., Schmidt, C. (2009). Adapting labour law and social security to the needs of the “new self-employed” -- comparing the UK, Germany and the Netherlands. *Journal of European Social Policy*, 19(2), 147–59.
- Taylor, M. P. (1996). Earnings, independence or unemployment: Why become self-employed? *Oxford Bulletin of Economics and Statistics*, 58, 253–266.
- Thaler, R. H., Benartzi, S. (2004). Save more tomorrow™: Using behavioral economics to increase employee saving. *Journal of political Economy*, 112(S1), S164–S187.
- Valsts Darba Inspekcija (The State Labour Inspectorate of Latvia). (2018). Pētījums “Pašnodarbinātība Latvijā un tiesiskā regulējuma pilnveide pašnodarbināto darba apstākļu uzlabošanai” [http://www.vdi.gov.lv/files/petijums\\_pasnodarbinatiba\\_latvija\\_un\\_tiesiska\\_regulejuma\\_pilnveide\\_pasnodarbinato\\_darba\\_apstaklu\\_uzlabosana.pdf](http://www.vdi.gov.lv/files/petijums_pasnodarbinatiba_latvija_un_tiesiska_regulejuma_pilnveide_pasnodarbinato_darba_apstaklu_uzlabosana.pdf)
- Valsts Darba Inspekcija (The State Labour Inspectorate). (2018). Pētījums “Pašnodarbinātība Latvijā un tiesiskā regulējuma pilnveide pašnodarbināto darba apstākļu uzlabošanai” [http://www.vdi.gov.lv/files/petijums\\_pasnodarbinatiba\\_latvija\\_un\\_tiesiska\\_regulejuma\\_pilnveide\\_pasnodarbinato\\_darba\\_apstaklu\\_uzlabosana.pdf](http://www.vdi.gov.lv/files/petijums_pasnodarbinatiba_latvija_un_tiesiska_regulejuma_pilnveide_pasnodarbinato_darba_apstaklu_uzlabosana.pdf)
- Valsts Ieņēmumu Dienests (State Revenue Service of Latvia), Data on tax payers – self employed persons, retrieved from <https://www.vid.gov.lv/lv/statistika/pasnodarbinatas-personas> on 20.08.2020.