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Better pensions for the European Union's self-employed

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Executive summary

Self-employed workers are taking on a larger role in the European economy, particularly workers who operate as independent contractors rather than as small-business owners with their own workforce. Becoming self-employed offers flexibility and entrepreneurial potential, but can limit access to state-sponsored pension schemes.

We assess the current state of pension policy across the European Union and take a more detailed look at five countries to see how independent workers are treated compared with their traditionally employed counterparts. We consider how policymakers might adjust or even overhaul their pension offerings to improve opportunities for the self-employed, while being mindful of the broader policy context in areas like innovation and overall tax burdens.

In assessing policy options, it is useful to determine whether government, companies or individuals will be primarily responsible for paying for better pensions, and we structure our suggestions accordingly. Governments can make programmes more widely available, more consistent for all types of work and easier to understand and take part in. Companies can be encouraged to make pension contributions for all their workers, not just those they hire full-time. Individuals can be encouraged to set aside more for retirement with tax incentives, benefits flexibility and other policy measures.

Access to pensions for low-income, more vulnerable self-employed workers should be considered separately from access for higher-paid workers. The current system does not facilitate this and indeed inhibits it in jurisdictions where a minimum income is required to join self-employment pension schemes.

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Introduction

As lifetime jobs and traditional labour protections recede, a new class of self-employed independent workers has emerged alongside the full-time workforce. Self-employed workers have reduced access to pension schemes and do not usually receive employer contributions to their pension pots. is presents a challenge to European pension systems, which are designed for traditional full-time employees and paid for in part by employers. As self-employment becomes more common, the long-term income security of self-employed workers is reduced due to lower pension incomes that introduce a higher risk of poverty. is will put the old-age security and other social protection systems of European welfare states, already stretched by aging populations, under even more pressure.

e self-employed receive lower public pensions and are less often covered by private pensions than traditional employees. Traditional employees have access to a mix of mandatory government-sponsored pensions, to which they and their employers both contribute, and voluntary private add-on plans. Höppner (2019) found that self-employment in Europe has a negative e ect on total pension amounts received by individuals. Similarly, Möhring (2015) found that longer periods of self-employment over the course of a career have a negative e ect on pension income.

Even when self-employed workers can access voluntary private pension plans, contribution limits vary and can be lower than for traditional employees. ese di erences in levels of contributions, access to and use of pension savings put self-employed workers at economic risk in retirement, and often result in their receiving lower pension income than employees. For instance, self-employed people in Germany on average in 2019 received only 51 percent of the average employee pension, according to Organisation for Economic Co-operation and Development data (OECD, 2019, Table 5.6).

A 2019 Council of the European Union Recommendation[1] highlighted the broad issue of unequal access to social protection:

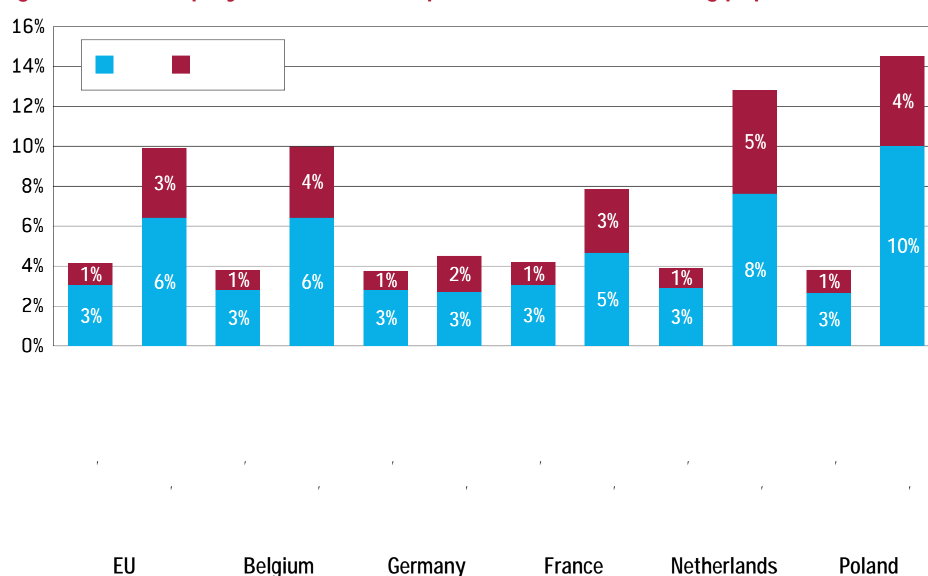
"some non-standard workers and some self-employed persons have insu cient access to the branches of social protection which are more closely related to participatin4

Who are the self-employed?

ere are two broad categories of independent workers: the solo self-employed (sole traders) and the self-employed with employees (small business owners). e solo self-employed include independent contractors, consultants, freelancers and on-demand platform workers. According to Eurostat's EU average (2020), the group of solo self-employed workers is 2.5 times larger than self-employed workers who have employees. Within the solo self-employed category are employees who have side gigs in addition to their full-time jobs, so they are both employees and self-employed. Unless otherwise speci ed, we use the term 'self-employed' to refer to the solo self-employed.

On average, about 14 percent of EU workers are self-employed. In 2020, 27.5 million workers identi ed themselves as self-employed. Of the countries we looked at, Poland and the Netherlands have the greatest percentages of self-employed workers (Figure 1).

Figure 1: Self-employed workers as a percent of active working population in 2020



Source: Bruegel based on Eurostat.

Like employees, the self-employed are a diverse group in terms of education and income levels, working in a variety of sectors and industries. In a comprehensive survey of 8,000 independent workers in the United States and across the EU, the McKinsey Global Institute (2016) found that self-employed workers vary by age, sector and industry, education levels and income. In the European Union, the self-employed are primarily managers, professionals and service and sales workers (Figure 2). Other signi cant groups are skilled agricultural, forestry and shery workers.

Figure 2: Self-employed workers by sector

Source: Bruegel based on Eurostat LFS database.

Self-employed workers work outside the traditional employment model both by necessity and choice. Some workers are forced by circumstances to work independently and would prefer to be full-time employees, but are in some way unable to secure a full-time job. Other self-employed workers choose explicitly to work independently to satisfy entrepreneurial ambitions or to pursue high levels of autonomy, exibility or control over their professional lives. Other self-employed workers work independently on the side, in addition to full-time jobs, and are thus traditional employees and self-employed workers at the same time.

workers who are standard employees have tertiary education, compared to only 2 percent of the lower-income self-employed.

As the workforce continues to transform and as independent work, self-employment and platform work become more common, it is reasonable to expect the number of self-employed workers to increase. ese changes in the workforce imply that a greater number of workers will have reduced access to the most protective pension schemes. ey are at risk of making lower pension contributions over their working lives and receiving inadequate pension income once they stop working.

Pensions for the self-employed

Pensions aim to generate a consistent stream of income for citizens who have aged out of the workforce, to allow them to enjoy a decent living standard and to protect them from poverty. State pensions are the primary source of income for older citizens in Europe, followed by employer pensions, then individual savings, according to the European Commission's *Pension Adequacy Report* (European Commission, 2018).

e European Pillar of Social Rights[2] stresses the importance of pension income in creat-

The OECD (2019) reported that, on average across 15 European OECD countries, the retired self-employed receive, at the median, public pensions that are 22 percent lower than retired employees. Reduced access to pension schemes and lower limits on contributions mean that self-employed workers don't even have the option of saving as much for their pension as employees. Spasova *et al* (2017) found that as a result, the self-employed run a comparatively high risk of poverty in nearly all European countries. The Survey of Resolution Foundation (D'Arcy, 2015) also found that 40 percent of the self-employed say they are not confident that retirement income will provide them with their hoped-for living standard.

Lower pension coverage levels can result from reduced access to pension schemes and from lower contribution levels. Spasova *et al* (2017) differentiated between statutory and effective access. The self-employed are excluded from statutory access to pensions in some countries, and in practical terms can face difficulties accessing pension schemes because of eligibility conditions, such as uninterrupted contribution periods.

Historically and generally pre-EU, member states developed their pension systems independently, and contribution rules, limits and amounts vary by country. For example, France, the Netherlands and Belgium tie contributions to income while Belgium has a minimum base that sets a floor on how low official income can go when making these determinations. Fiscal matters remain largely national responsibilities in any case, which also affects how pensions are taxed and funded.

Self-employed workers are not subject to mandatory pension contributions, so can choose how much and whether they save. This is a risky construct from a policy perspective since individual workers who don't save, or save inadequately, ultimately rely on state pensions. Workers with lower levels of compensation, including the vulnerable group, or those with unstable sources of income, often save less.

The ECB's 2017 *Household Finance Consumption Survey* (Eurofound, 2021) analysed

Figure 4: Employer vs employee contributions to mandatory pension schemes

Source: Bruegel based on OECD.

Variations in pension schemes across the EU

One of the challenges in evaluating pension schemes is nding how to compare speci cs without being either so broad or so detailed that one loses sight of the policy under discussion. In this section we present a higher-level discussion of the various pension schemes in several European states. See Annex 1 for more detail, including contribution levels and tax treatment of some options.

Economic literature suggests that four institutional characteristics are relevant in comparing old-age security systems for the self-employed (Choi, 2009; Fachinger, 2003; Traub, 2013). e rst is whether there is a universal basic pension with a at-rate bene t. is means that all workers, regardless of employer or individual savings, are guaranteed a pension with a minimum bene t. is is only the case in Denmark, Sweden the Netherlands, and Switzerland.

Second, some countries provide an earnings-related pay-as-you-go (PAYG) public pension. A pay-as-you-go system is a pension scheme in which bene ciaries decide on the amount of contributions they wish to make, either by having the amount deducted regularly from their pay cheque or by paying in a lump sum. ese plans generally do not pre-determine the amount of income that will be received in retirement. Overall, this type of system is quite common across the EU. Some countries have implemented plans that can be combined with a basic pension (Sweden and Denmark), but most have not (Germany, France, Belgium, Austria, Poland, Italy and Spain). Only the Netherlands and Switzerland do not o er a PAYG pension scheme.

ird is understanding if old-age security for the self-employed is mandatory. In Italy, Spain and Germany there is no mandatory old-age security for the self-employed. In Denmark, the self-employed can choose to be insured in an earnings-related public scheme (*ATP Livslang Pension*

Closing thoughts

Perhaps the strongest argument for closing the gap of access to pensions comes from the 2019 Council Recommendation:

"In the long run, the gaps in access to social protection could put at risk the welfare and health of individuals and contribute to increasing economic uncertainty, the risk of poverty and inequalities. They could also lead to suboptimal investment in human capital, reduce trust in institutions and limit inclusive economic growth. Such gaps could also reduce the revenues of social protection if a growing number of people do not contribute to the schemes."

It is difficult to justify current pension savings policies that limit the pension contributions, benefits and future income security of self-employed workers while giving employees maximum access to public retirement savings, employer cost-sharing and private savings plans. This lopsided approach segments the labour market, limits labour mobility and creates distortionary incentives for companies in the allocation of work across the economy. It does not serve self-employed workers well, nor does it serve the European governments that must ultimately provide a retirement social safety net. Instead, the status quo's main benefits seem to accrue to companies that are released from the responsibility for contributing to long-term income security, to the extent that they hire self-employed workers.

Independent work has the potential to offer welcome choice to individuals, who may prefer its autonomy and flexibility, and to companies, which may wish to supplement their full-time workforce with other human resources. Finding the right balance shouldn't require big trade-offs in retirement planning.

The goal of pension policy is to ensure that all workers have equitable access to pension savings schemes and long-term income security. Improving access to pension savings for self-employed workers and requiring companies to contribute to the pensions of all workers they hire are possible policy approaches to create a more equitable, sustainable and effective pension system, and to ensure a secure retirement for all.

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France

Traditional employees

France has both a state-sponsored pension plan and private plans. However, private pension plans are relatively new and are not very popular. Additionally, private plans are typically set up as a type of life insurance that will provide for monthly payments upon retirement, rather than a savings or investment account. Both the employer and the employee pay into a state sponsored plan. In a private plan, the employer will likely set up the plan but will not contribute. An employee may draw their pension at the age of 62 if they were born after 1955. Before 1955 the age varies slightly. An employee born after 1955 may not draw a full pension however, until they reach 67 years of age.

Self-employed workers

Independent workers have been added to the French state-run pension plan in the last few years and are now eligible to take part in the general social security programmes if they register with their local health insurance fund to become a part of. There are different funds depending on the type of work a person does, with contributions from the workers. For some

while there is no mandatory overall pension requirement, individual professions can choose to make participation mandatory for workers in that sector. Voluntary private plans can cover anyone, and contributions are made by the individual employee who sought to enter into the plan. Retirement age as of 2020 is 66 years. e age will change to 67 years as of 2024. An individual must have resided in the Netherlands for 50 years to receive their full pension or there will be a deduction of 2 percent per missed year.

Self-employed workers

ere are not many options for self-employed/independent workers in the Netherlands. ere are some voluntary private pension plans or occupational pension plans, but these are restrictive. Private pension plans allow the individual worker to contribute what they can to a pension fund for themselves. Occupational pension plans allow self-employed/independent workers to enter a sector pension fund if they work within the same sector for an extended period of time. e occupational fund also does not allow for the uctuations that can occur in the income of self-employed workers. Payments would be made solely by the individual unless the worker is part of an occupational pension plan in a certain sector that would also make payments. Almost no pension funds are mandatory unless the sector decides otherwise. Age same as for employees.

Poland

Traditional employees

Poland has a three-pillar pension system: the rst pillar is a government-funded pay-as-you-go system; the second pillar is voluntary pension funds headed by private nancial institutions that invest money in the capital market; and the third pillar combines voluntary occupational pension system and private pension plans. For the rst two pillars, contribution rates are split equally between employers and employees, with most of the total going into the public rst pillar, and the rest credited to the private individual account scheme and paid entirely by the employee. e second pillar includes the option to opt-out entirely and directs that money to the public programme. For the third pillar, the employer pays voluntary occupational pension plans up to 7 percent of employee net earnings. Employees can make additional contributions that supplement those of the employer. e pension age is 65 years for men and 60 years for women, who can document a contributory period covered amounting to 25 and 20 years, respectively.

Self-employed workers

In Poland, self-employed and independent workers can participate to a certain extent in the pension system. ey are required to participate in the rst and second pillars, they must contribute from their funds, and the amount is lower than for traditional employees. For the third pillar, they may voluntarily take part in a private pension plan, but they cannot participate in the occupational pension option. e pension age is 65 years for men and 60 years for women.

Annex 2: Types of self-employed income that may not be fully declared

Under-reporting of self-employment income can limit the pension contributions a worker can make, resulting in lower total pensions savings.

Main types of undeclared work in member state	Germany	France	Belgium	Netherlands	Poland
Declared work with an undeclared element (envelope wages) and undeclared/o -the-books employment	x		x	x	x