Theoretical relative pensions of the self-employed

Key results

Self-employed workers with a taxable income (i.e. net of social security contributions) equal to the net average wage before tax (gross wage net of employee's contributions) can, on average in the OECD, expect to receive an old-age pension equal to 79% of the pension of the average-wage dependent worker in the private sector.

While the self-employed are required to participate in earnings-related pension schemes in most countries, they contribute the combined employee and employer contributions only in Canada, Costa Rica, Czechia, Estonia, Finland, Hungary, Korea, Lithuania, Luxembourg, Portugal, Slovenia, Türkiye and the United States (Table 5.5). Even in these countries, insufficient compliance with rules may undermine pension coverage.

In 13 countries, while self-employed workers are mandatorily covered by earnings-related schemes, pension coverage is limited because they are allowed to contribute less than employees, through reduced contribution rates (France, Iceland, Israel, Italy, Latvia, Norway, the Slovak Republic, Sweden and Switzerland), or flat-rate contribution (Colombia, Greece, Poland and Spain). Chile is currently in the former category but, after reform, will be employee-like from 2027. In Austria, the state contributes 4.3% for the self-employed to fully offset the lower contribution rate they pay (18.5%) compared with that of employees and employers (22.8%) for dependent employees. In Belgium, contribution rates are lower for the self-employed than for employees but the accrual rate is the same for both. In Australia, Denmark, Germany, Japan, Mexico and the Netherlands, the self-employed are, in contrast to employees, not required to join earnings-related schemes. In Ireland, the self-employed participate in contribution-based basic schemes on similar terms as employees while the earnings-related schemes are voluntary for all, whilst in New Zealand there are no mandatory pension contributions for either employees or the self-employed.

In countries where the self-employed are not required to contribute to earnings-related pension schemes the relative pension level is among the lowest as the pension of the self-employed is limited to first-tier benefits. In the full-career case, the relative pension of the self-employed is about half that of employees in Denmark, Germany, Greece and the Netherlands and is much lower in Mexico (17%) and Japan (34%) (Figure 5.6). Among countries with no mandatory contributions to earnings-related pensions by the self-employed, Australia stands out, as the means-tested basic pension actually gives the self-employed 109% of what average-wage employees get from mandatory schemes.

Low relative pensions for the self-employed – between 40% and 60% of employees' pensions – are also projected in Greece, Poland and Spain where only flat-rate contributions to earnings-related schemes are mandatory for the self-employed, and at 75% in Latvia, where mandatory contributions above the minimum wage are reduced substantially.

Lower contribution rates and a reduced contribution base result in lower pensions from mandatory earnings-related schemes for the self-employed relative to employees with the same taxable earnings in many countries. For example, in France (points scheme) and Italy, reduced contribution rates directly affect entitlements within the public system while in Norway, Sweden and Switzerland pensions are lower because the self-employed are not obliged to pay any contributions towards the occupational schemes. As a result, pensions of the self-employed relative to employees reach 51% in Switzerland; 66-70% in Italy and Sweden; between 74% and 87% in Chile, Costa Rica, Colombia, Czechia, Israel, Portugal and Slovenia; and above 90% in Estonia, France, Iceland, Korea, Lithuania and Norway.

Lower contributions of the self-employed do not always result in proportionally lower pensions. For example, in Czechia, progressive replacement rates result in the relative theoretical pensions of the self-employed reaching 87% even though the contribution base is set at only 50% of taxable income. In Belgium and Norway, the reduced contribution rates to public schemes do not reduce the benefits implicitly while in Austria and Costa Rica the reduced contributions of the self-employed are explicitly topped up with taxes.

Some countries calculate pensions of the self-employed based on gross income, i.e. income before deducting contributions. This leads to higher pensionable earnings "all else equal" in the case studied here (taxable income of the self-employed equal to the net wage before tax) when the contribution rate paid by the self-employed is higher than the employee part for dependent workers. Hence, the theoretical pension of the self-employed is slightly higher than that of employees in Austria and Luxembourg. The United States allows the self-employed to deduct half of social security contributions before calculating the contribution base. Given that employees and employers pay equal shares of contributions, this deduction equalises theoretical pensions between the self-employed and employees.

Definition and measurement

Theoretical pensions of a self-employed worker relative to an employee assumes that both have a taxable income (net income or net wage before taxes) equal to the average net wage before taxes, their career starts at age 22 in 2022, they do not face any interruptions and they retire at the normal retirement age. They contribute the amount that is (quasi) mandatory to pensions.

Table 5.5. Contributions requirements to mandatory and quasi-mandatory pensions for the self-employed

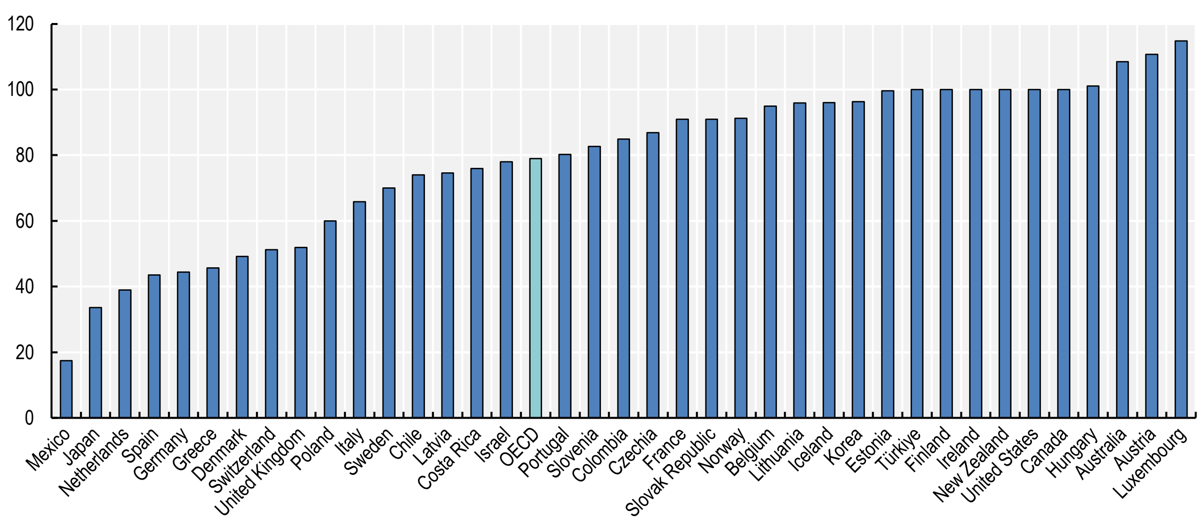
Mandatory or quasi-mandatory contributions to earnings-related schemes			Mandatory contributions to basic pensions only	No mandatory pension contributions
Employee-like	Reduced contribution rate	Flat-rate or lower contributions		
Canada	Austria*	Colombia	Ireland	Australia
Costa Rica	Belgium	Greece	Japan	Denmark
Czechia	Chile**	Poland	Netherlands	Germany
Estonia	France	Spain	United Kingdom	Mexico
Finland	Iceland			New Zealand
Hungary	Israel			
Korea	Italy			
Lithuania	Latvia			
Luxembourg	Norway			
Portugal	Slovak Republic			
Slovenia	Sweden			
Türkiye	Switzerland			
United States				

Note: *The self-employed contribute 18.5% compared to a total contribution rate of 22.8% for the employee and employer combined, but the remaining 4.3% for the self-employed is financed by the state. **Following the completion of the phase-in reform (2018-2027) Chile will move to the employee-like column. Employee-like means that self-employed are covered by the same or equivalent schemes as employees, have the same contribution rates and thresholds, and that their contributions are income based. In Ireland neither self-employed nor dependent workers are covered by mandatory or quasi-mandatory earnings-related schemes, but basic pensions are financed with contributions.
Source: Country Profiles available at http://oe.cd/pag.

StatLink https://stat.link/beg4kf

Figure 5.6. Theoretical relative pensions of the self-employed as a percentage of those of employees

Theoretical pensions of a self-employed worker relative to an employee having both a taxable income (net income or net wage before taxes) equal to the average net wage before taxes, for individuals with a full career from age 22 in 2022 and contributing only the amount that is (quasi) mandatory to pensions



Source: OECD pension models.

StatLink https://stat.link/xj3b0n

From:

Pensions at a Glance 2023

OECD and G20 Indicators

Access the complete publication at:
https://doi.org/10.1787/678055dd-en

Please cite this chapter as:

OECD (2023), "Theoretical relative pensions of the self-employed", in *Pensions at a Glance 2023: OECD and G20 Indicators*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/49b8f469-en