

IMPERFECTIONS OF SOCIAL INSURANCE FOR SELF-EMPLOYED PERSONS IN LATVIA

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Abstract. Self-employment plays a significant role in employment. Recently, self-employment is being enhanced both by entrepreneurs' wish to reduce labour costs and wish of employees themselves to pay less for their social insurance. In Latvia, the status of self-employed allows reducing mandatory payments for personal social insurance, and a person earning less than the state minimum salary, may choose not to make social contributions at all. The object and minimum amount of mandatory state social insurance contributions (MSSIC), making which a self-employed person may become socially insured, annually increase with the increase of minimum salary. Actually, every year more and more people with low income are left outside the security system under the regulations of the current social insurance system for self-employed persons in Latvia. This causes additional risks to the social insurance system, since part of the population is subject to the poverty risk when reaching the retirement age or becoming unable to work due to other reasons. The comparison of the state social insurance system for self-employed persons in Latvia and Lithuania allows concluding that all self-employed persons in Lithuania are subject to the mandatory state social insurance system. The authors believe that the state social insurance system of Latvia requires changes to cover also self-employed persons with lower income. Besides, in Latvia, pursuant to the amendments to the law "On State Social Insurance", every employee will be subject to social insurance at least for the amount of the minimum salary starting from 2017; however, no changes are planned regarding the state social insurance of self-employed persons.

Key words: self-employment, social contributions, state social insurance.

JEL code: H21, H55

Introduction

In contemporary economic situation, when the labour market becomes more flexible and new opportunities are emerging there, part of the population in Latvia, as elsewhere in the world, rather choose to undertake independent economic or professional activity versus paid employment. Also small businesses seek for possibilities to reduce operational expenses, including tax payments. In Latvia, self-employed persons feature an opportunity not to make social insurance contributions, if their income calculated as the difference between operating revenues and expenditure is below the minimum monthly object of social contributions (equalling to the amount of the minimum salary, which is EUR 370 in 2016). In case income exceeds the minimum object of social contributions, a self-employed person may make MSSIC from the minimum object of social contributions. As income for the majority of self-employed persons is small and does not exceed the minimum object of contributions, they do not join the social

insurance system, and thus, remain without any social guarantees in the future. Moreover, making of social contributions from the minimum object of contributions does not guarantee sufficient social services in the future. It means that in the future there will be a part of population in Latvia who reaching the retirement age would not have earned even the minimum pension determined by the state. The research **hypothesis:** the present social insurance system of Latvia leads to a situation that a large part of self-employed persons do not make MSSIC, and thus are not socially insured. The research **aim** is to study the necessary changes to the state social insurance system to increase social guarantees of self-employed.

The following research **tasks** serve for the achievement of the research aim: 1) to analyse data on the trends of self-employment in Latvia and other EU Member States; 2) to analyse problematic aspects of social insurance for self-employed persons in Latvia; 3) to compare the state social insurance system for self-employed persons in Latvia and Lithuania; 4) to provide

recommendations to improve the state social insurance system for self-employed persons.

The research covers the period 2008-2014, sometimes a shorter period is analysed due to the lack of data. The study employs monographic and descriptive statistical methods.

Research results and discussion

1. Trends of self-employment in the EU

Member States

In general, almost 15% of employed people in the EU Member States are self-employed

persons. The share of self-employed persons of total employees greatly differs among the Member States (Table 1). The highest share is registered in Greece (30.8% in 2014), while the lowest one in Luxembourg and Denmark (7–8%). Analysing the closest neighbouring countries, Poland has traditionally demonstrated high level of self-employment; though, the level has slightly decreased during the recent years.

Table 1

The share of self-employed persons in the EU Member States of total number of employed (from 15 to 64 years), %

Range No	Country	2008	2009	2010	2011	2012	2013	2014
1	Greece	28.5	28.8	29.3	30.1	31.1	31.7	30.8
4	Poland	18.5	18.4	18.8	18.8	18.5	18.2	17.9
	European Union	14.6	14.6	14.6	14.5	14.6	14.5	14.5
21	Latvia	8.7	9.8	9.9	10.1	10.3	10.5	10.6
22	Lithuania	10.2	10.2	9.1	9.0	9.6	10.5	10.6
25	Estonia	7.7	8.2	8.2	8.3	8.5	8.8	8.9
27	Denmark	n.d.	n.d.	7.1	8.5	8.4	8.9	7.9
28	Luxembourg	6.2	7.3	7.1	7.8	8.0	8.0	7.7

Source: Eurostat data, 2015

In the Baltic States, the share of self-employed persons is one of the lowest ones among the EU Member States. The lowest share is registered in Estonia (8-9%), which ranks the country in the 25th position among the Member States. In 2008-2009, the highest share of self-employment among the Baltic States was observed in Lithuania; though, in recent years, Latvia has outpaced Lithuania in terms of self-employment. Latvia ranks in the 21st position among the Member States, moreover, the share of self-employed persons grows more rapidly in Latvia than in other countries (from 8.7% in 2008 to 10.6% in 2014). An especially fast increase was registered in 2009, which was related with the decrease in jobs and a respective growth in the share of self-employed due to the economic crisis. However, in Latvia, a slight

increase in the share of self-employed persons remains also in the after-crisis period.

Several researchers have studied reasons for the increase in the share of self-employed. Already in 1999 A. Supiot wrote about new employment trends in Europe. Essential factors promoting the increase of self-employed or independent business persons are as follows: 1) employers' wish to reduce their obligations towards employees and simultaneously labour costs through not making social insurance contributions; 2) well-educated young employees themselves choose self-employment to reduce their expenses in social insurance schemes, as the high social insurance contributions are lower the possible benefits gained through different allowances and pensions. The trends of this "new employment" raise problems to social policy-makers of any country (Westerveld, 2012).

2. Trends of self-employment in Latvia

As indicated above, the share of self-employed persons in Latvia has gradually increased during the recent years. This is also

evidenced by the data of the Central Statistical Bureau (CSB) of the Republic of Latvia (Table 2): increase from 5.4% in 2008 to 6.8% in 2014 (from 8.7% to 10.6% respectively according to the Eurostat data).

Table 2

Primary employed population of Latvia by employment status in the period 2008-2014, number (thou.), share (%)

Indicator	Unit	2008	2009	2010	2011	2012	2013	2014
Primary employment, TOTAL	thou.	1054.9	908.5	850.7	861.6	875.6	893.9	884.6
incl. employees	thou.	946.8	803.8	752.9	763.9	776.1	790.4	782.4
	%	89.8	88.5	88.5	88.7	88.6	88.4	88.5
Employer (owner)	thou.	36.6	34.2	33.5	31.5	34.1	37.5	35.2
	%	3.5	3.8	3.9	3.7	3.9	4.2	4.0
Self-employed person	thou.	57.4	56.5	52.3	56.6	57.4	58.2	59.8
	%	5.4	6.2	6.1	6.6	6.6	6.5	6.8
Unpaid family workers	thou.	14.1	14	12	9.6	7.9	7.5	7.1
	%	1.3	1.5	1.4	1.1	0.9	0.8	0.8

Source: CSB data, 2015

The definition of self-employed person explains the discrepancy between the data. The Central Statistical Bureau of the Republic of Latvia considers a self-employed person to be a person who works in own business, professional practice or farm for the purpose of earning a profit and who does not employ any other persons. According to the Eurostat definition, **self-employed persons** are the ones who work in their own business, farm or professional practice. Therefore, according to the CSB data, the level of self-employment is significantly lower compared with the Eurostat data. In fact, the number of self-employed persons should also include a large part of employers (owners) who are accounted according to the CSB data. In addition, Table 2 shows only primary employed persons. More common trend is to be an employee and at the same time to earn income as self-employed person.

In the economic downturn period, Latvia experienced a significant decrease in the number of employed persons, reaching the lowest level in

2010 (850.7 thousand employed persons). Accordingly, the number of employees decreased, leading also to a decrease in the share of employees, i.e. from 89.8% in 2008 to 88.5% in 2014. The share of self-employed and the share of employers (owners) increased, in turn. In Latvia, the share of self-employed grew both during the crisis and after-the-crisis periods, thus, part of population being unable to find work became permanent self-employed persons or even employers (owners).

3. Trends in social insurance of self-employed persons

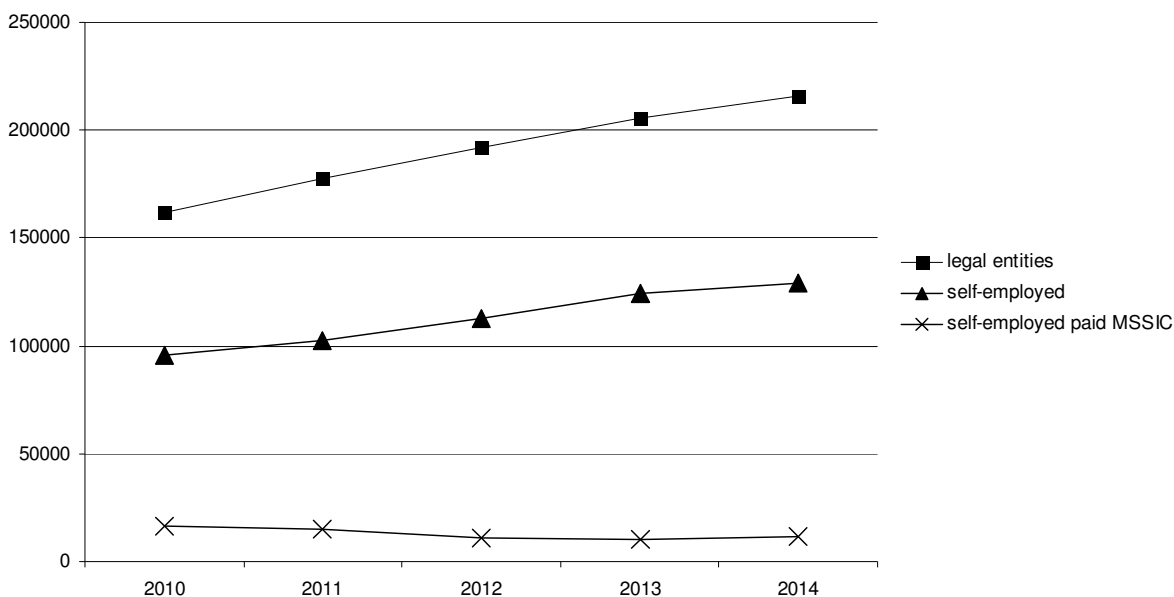
The State Revenue Service (SRS) data on self-employment differ from the CSB data. The reason for discrepancies is that the SRS displays data on all natural entities having registered economic activity. These persons include also the self-employed people who actually are not doing active business; although, they have registered it. However, the number of such inactive self-employed persons is considerably decreasing

from 2014, and especially it decreased in 2015, due to the introduction of the minimum annual income tax payment of EUR 50 in 2014 independent of the income size.

According to the SRS information, on 1 January 2015, there were 129 124 performers of economic activity registered in Latvia. The number of socially insured self-employed persons, in turn, was considerably smaller as only the persons making MSSIC are socially insured. In the last quarter of 2014, only 11 466 self-employed persons or only 8.9% of registered tax payers – natural entities made MSSIC. Practically, the share is even smaller, since in Latvia, not only natural entities registered by the SRS make the MSSIC as self-employed persons; the contributions are made also by the owners of agricultural farms (around 28 thousand) and fishery farms (around 100) as well as individual merchants (around 12 thousand). It should be considered that part of self-employed persons is

exempted from the MSSIC, for example, farmers at the retirement age and disabled people of Groups 1 and 2. However, the general conclusion is that only a small percentage of self-employed persons make MSSIC, thus, insuring themselves socially.

Analysing the period from 2010 to the end of 2014, it is seen that the number of taxpayers in Latvia is generally increasing (Figure 1): legal entities by 7.5% on average per year, natural entities – by 7.9% per year. Moreover, taxpayers – natural entities are nearly 60% of the number of legal entities. Hence, natural entities as performers of economic activity make a very significant share of taxpayers. Consequently, the state social insurance of these natural entities reveals a worrying trend as the share of insured persons has rapidly declined during the period analysed, i.e. from 17.2% in 2010 to 8.9% in 2014.



Source: SRS data, 2015

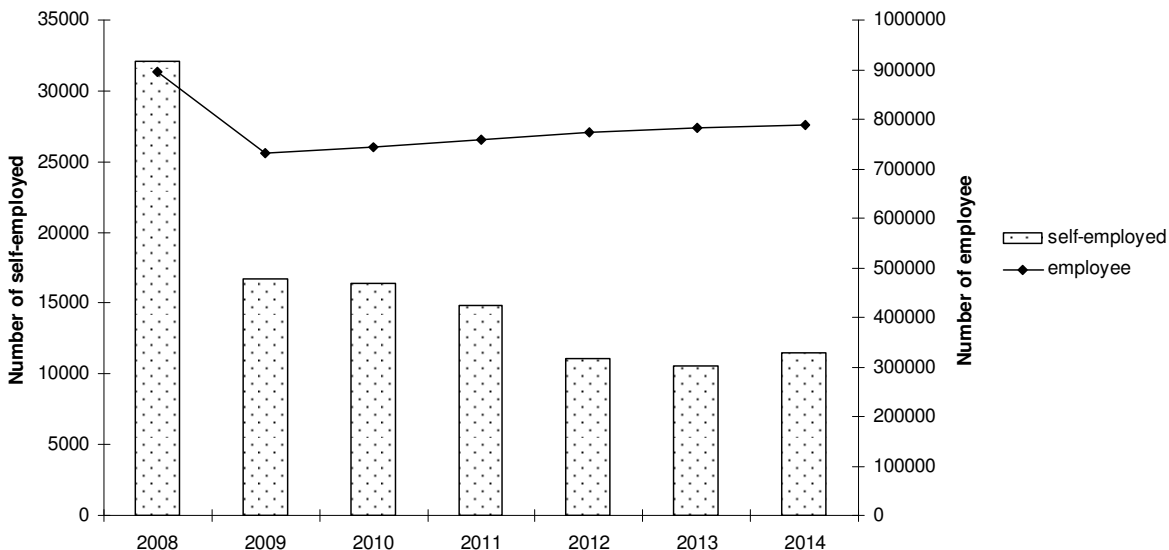
Fig. 1. The number of registered taxpayers by legal entities, natural entities and self-employed persons making MSSIC in Latvia

Comparing social insurance of employees and self-employed persons, it has to be recognised that the essential decrease in the number of socially insured persons both as employees and

self-employed persons has been the result of the 2009 financial crisis in Latvia (Figure 2). However, the number of employees gradually and slightly increases from 2010, while the

number of socially insured self-employed persons continues to decrease with every year; an

increase was observed only in 2014 (+8.3% compared with 2013).



Source: the SRS data, 2015

Fig. 2. The number of socially insured self-employed persons and employees in Latvia

According to the SRS data, about 30% of self-employed persons are also employees and receive regular income in the form of salary, thus, they are appropriately insured. Though, only a part from the remaining 70% of self-employed persons is involved in the state social

insurance system. Hence, it may be concluded that the majority of self-employed persons in Latvia are not socially insured at all; besides, even those who make MSSIC pay relatively small amounts, most often from the state minimum salary.

Table 3

Social insurance contributions made by self-employed persons in Latvia

Indicators	2008	2009	2010	2011	2012	2013	2014
Total MSSIC, mln EUR	2037.8	1806.5	1590.0	1794.9	1936.6	1980.1	2053.8
Self-employed persons making MSSIC, mln EUR	12.1	11.2	9.3	10.6	11.1	11.1	11.7
Share of self-employed persons making MSSIC, %	0.59	0.62	0.58	0.59	0.57	0.56	0.57
Number of self-employed persons making MSSIC	32114	16677	16407	14888	11110	10587	11466
Average annual amount of MSSIC made by 1 self-employed person, EUR	376.78	671.58	566.83	711.98	999.10	1048.46	1020.41
Minimum annual amount of MSSIC for self-employed persons, EUR	779.62	936.84	865.80	1076.40	1108.44	1098.60	1192.68
Contributions made from the minimum amount of contributions, %	48.3	71.7	65.5	66.1	90.1	95.4	85.6

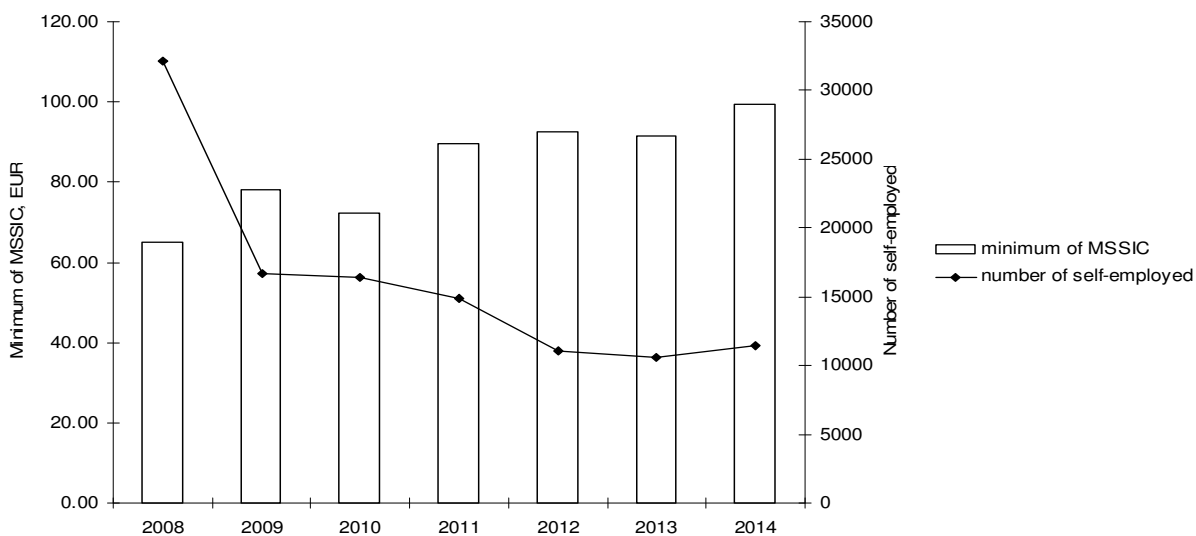
Source: authors' calculations based on the CSB and SRS data

In 2014, the total amount of MSSIC made in Latvia has grown very slightly, i.e. by 0.79% (from EUR 2037.8 mln to EUR 2053.8 mln) compared with 2008; so after the economic crisis it has returned to the 2008 level. In contrast, contributions made by self-employed have decreased by 3.31% (from EUR 12.1 mln to EUR 11.7 mln) within this period with a simultaneous decrease of the share of contributions made by self-employed in total MSSIC (decrease from 0.59% to 0.57%). In addition, mandatory contributions made by self-employed are very small given the fact that self-employed account for 1/10 of all employed persons in Latvia.

A positive trend is the increase in the amounts of contributions calculated as average per one insured self-employed person – from EUR 376.78

in 2008 to EUR 1048.46 in 2013, with a slight decrease in 2014 (EUR 1020.41). Consequently, the ratio of actually made contributions against the minimum annual amount of contributions has increased from 48.3% in 2008 to 85.6% in 2014. This allows concluding that the share of self-employed persons making contributions on a regular basis increases compared with those make MSSIC for several months per year.

Deterioration of the situation in the sphere of self-employed social insurance requires searching for its reasons. The economic crisis which undeniably very heavily affected Latvia, left traces also on the financial position of entrepreneurs and self-employed persons and their ability to insure themselves socially.



Source: the SRS data, 2015

Fig. 3. Number of self-employed persons making MSSIC and minimum of MSSIC

Figure 3 displays a reverse connection between the increase of minimum amount of MSSIC made by self-employed persons and the decrease in the number of insured self-employed persons. Such trend essentially threatens the state social insurance system and social insurance of self-employed. Partially, the possibility introduced in Latvia in 2010 allowing self-employed persons to choose either paying a licence fee or a micro-enterprise tax (MET), which includes also MSSIC, instead of the general

tax payment regime explains the decrease in the number of self-employed making MSSIC. However, this is not the only reason for the decline in the number of socially insured self-employed persons.

At present, self-employed persons in Latvia may choose among three tax payment regimes: 1) general procedure; 2) licence fee, which is a constant payment depending on the field of activity and ranging between EUR 43 and EUR 100 per month; and 3) micro-enterprise tax,

which is 9% of all operating revenues. Moreover, social insurance of self-employed persons essentially differs among these tax regimes. Table 4 provides different possibilities of the state social insurance for self-employed and comparison of these possibilities with the situation in Lithuania.

Various types of craftsmen and providers of individual services, for example, beauty services, are eligible to a licence fee, which includes also social insurance contributions (65% of the licence fee payment). The licence fee for craftsmen is

small (EUR 43), and thus, MSSIC of self-employed are very small – EUR 28 per month; while the licence fee for self-employed - service providers is up to EUR 100 per month, thus, the MSSIC may reach EUR 65 per month. However, the MSSIC calculated from the licence fee are 2-3 times smaller compared with the contributions made by self-employed persons consistent with the general tax regime. In addition, all licence fee payers are insured only for two types of insurance: pensions and disability.

Table 4

Comparison of self-employed social insurance system in Latvia and Lithuania in 2015

Indicator	Latvia			Lithuania	
	any self-employed	paying a constant license fee	paying MET	any self-employed (1)	with business license (2)
Maximum annual revenue	Not limited	EUR 50 000	EUR 100 000	Not limited	EUR 45 000
Minimum MSSIC	If the income (revenues - expenses) is below the minimum salary, MSSIC are not made	License fee, depending on the field EUR 43-100 per month, from which 65% are redistributed as MSSIC, so MSSIC are EUR 28-65 per month	MET is 9% of revenues, from which 72.4% are redistributed as MSSIC, so MSSIC are 6.52% of revenues	MSSIC are made from 1/2 of income (revenues - expenses). Rate 28.5% + 9%	MSSIC are made from 1/2 of the minimum pension (from EUR 56). Rate 28.5% + 9%
Types of insurance	Pension, sickness and maternity, disability, parental insurance	Pension, disability	Pension, sickness and maternity, disability, accidents at work and occupational diseases, unemployment, parental insurance	Pension, maternity, health insurance	Pension, health insurance
Main problems	Most of self-employed persons are not subject to social insurance	Social insurance is very small, and includes only 2 types: pension and disability insurance	Covers all types of social insurance, depending on earnings	Self-payments can be quite large	Social insurance is very small, and includes only 2 types: pension and health insurance

Source: authors' construction based on the laws of the Republic of Latvia and the Republic of Lithuania

Self-employed persons, who choose to pay a micro-enterprise tax, are insured for all six types of state social insurance. Besides, their amount of insurance directly depends on the revenues earned from the performed economic activity, as the micro-enterprise tax is calculated from the revenues and 72.4% of paid tax is redistributed as MSSIC. A positive aspect is that recently the redistribution in favour of MSSIC has increased

compared with the period between 2010 (introduction of MET) and 2014, when 65% of the micro-enterprise tax payments were redistributed in favour of MSSIC.

Problematic situation is with those self-employed persons who choose to pay taxes consistent with the general procedure. According

to the statistics, only a very small part of them make MSSIC, since the law allows not making contributions until their monthly income reaches the minimum object. Therefore, a large part of self-employed persons are not included into the state social insurance (SSI) system.

In Lithuania (Table 4), self-employed persons of the two groups are included into the state social insurance system: Group 1 makes MSSIC from half of their income, while self-employed having received a business licence and belonging to Group 2 make MSSIC from the object which is equal to half amount of the state minimum pension. Similar to Latvia, in case of paying a licence fee the insurance of Group 2 self-employed persons is relatively small; however, they are involved in it and are forced to ensure their social security at least on a minimum amount.

In 2015, Lazdina (2015) within the scope of her Master's thesis conducted an inquiry to identify factors hindering the willingness of self-employed persons in Latvia to participate in the state social insurance system and changes required for enhancing people to make social contributions. The research results demonstrate that only about 25% of self-employed persons make contributions as they wish to care about their social security. The majority or 67% do so only because the law imposes such an obligation. Additional reason why social contributions are made is a desire to receive higher parental insurance or maternity benefit. In such cases, contributions are made temporarily before the receipt of the planned benefit; here the aim is to increase the amount of benefit. In contrast, small amount of income allowing not making contributions mandatory or inability to afford making contributions due to their large minimum amount are the most frequently mentioned reasons why self-employed persons decide not to make contributions. According to the survey results, self-employed persons were encouraged to participate in the social insurance system if the

insurance procedure would allow them to make contributions in the amount people can afford to do so. The research concludes that self-employed persons are interested in the insurance system which involves completely all self-employed people regardless of their income level and make contributions commensurate to their income.

Therefore, it leads to a conclusion that the social insurance system for self-employed in Latvia requires changes by involving a wider range of self-employed people. Moreover, in Latvia starting from 2017 consistent with the amendments to the law "On State Social Insurance" every employee will be subject to the social insurance at least in the amount of minimum salary, while no changes are planned regarding the state social insurance of self-employed persons. Hence, making of mandatory state social insurance contributions will not encompass all employed people.

Self-employed persons with the income below the minimum object of contributions and simultaneously being employees and making MSSIC at least from the minimum salary might be exempted from making mandatory state social insurance contributions. A gradual introduction of MSSIC is required regarding the other self-employed persons whose income is below the minimum object of state social contributions. In this case, the minimum object of MSSIC could equal to a half of the minimum salary. For example, in 2016, the minimum object of MSSIC could be EUR 185 ($\frac{1}{2}$ of EUR 370), contributions made by a self-employed person – EUR 56.57 ($185 * 30.58\%$). Similar to the case of a licence fee, the insurance could also cover pension and disability types of insurance. Therefore, it would be possible to achieve a situation when every self-employed person is included into the state social insurance system and regularly makes accruals for own security; so avoiding temporary joining to the state social insurance system before the receipt of social services.

Conclusions and recommendations

- 1) The number and dynamics of self-employed persons greatly differ by the EU Member States; in recent years, the share of self-employed in the EU countries accounts for 14.5% on average of total employed people.
- 2) In Latvia, social insurance of self-employed persons becomes a more topical problem since the number of self-employed is relatively large (10.6% of total employed people in 2014). Moreover, the number is increasing lately with the decrease in the number of self-employed making social contributions (from 17.2% in 2010 to 8.9% in 2014).

3) In Latvia, only a small part of registered performers of economic activity is socially insured, while in Lithuania, the state social insurance system covers all self-employed persons.

4) In Latvia, the inclusion of all employed people in the state social insurance system requires a gradual introduction of MSSIC also for self-employed persons whose income is below the minimum salary by determining the minimum object of MSSIC smaller compared with the general procedure, for example, half of the minimum salary.

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