National report - Latvia

Etuc SociAll Project

Author: Linda Romele

Participating National Trade unions: LBAS

Final version 05.12.2020

Executive summary

The Latvian pension system has been recognised as one of the most sustainable in the world. The German insurance and asset management company Allianz Global in the “Pension Sustainability Index 2016” acknowledged the Latvian pension system as the seventh most sustainable in the world. Furthermore, Latvia ranked 2 places higher in 2016, when compared to 2014. According to the 2016 Index, it is only Australia, Denmark, Sweden, the Netherlands, Norway and New Zealand, that had a more sustainable pension system than Latvia, which ranked better than both Lithuania and Estonia.

At the same time, the average amount of paid pensions in 2018 was below the poverty line, in 2019 30% of all pensioners received a pension of up to 300 euro, while 70% of all pensioners received a pension of up to 400 euro. The at-risk-of-poverty threshold in 2018 was €409. However, low pensions are only one part of the problem, the other being low life expectancy, particularly healthy life expectancy, which practically does not leave the opportunity to spend high-quality ageing.

In recent years, several significant improvements have been made to the pension system. The provision for the possibility of inheriting accrued pensions at 2nd pension level was implemented (the second pillar pension scheme or state mandatory funded pension scheme – FDC). Furthermore, the surviving spouse can receive the deceased’s pension for a limited amount of time and commission fees for governance of the 2nd pension level were reduced. The system is gradually moving towards social security and funded pension schemes, mitigating the negative effects of the transition from one system to another. Collective agreements play a small part in the management and regulation of pensions, in practice only one closed pension fund has been established. The role of trade unions is moderate, playing a key role when it comes to specific issues or aspects, such as service pensions or early retirement opportunities in certain occupations. At the national level, trade unions are more in favour of general issues, as was the case in 2013 and 2014, when the retirement age was raised.

---

1 - The Latvian pension system is recognised as one of the ten best in the world in the Pension Sustainability Index (PSI) compiled by the German insurance and asset management company Allianz Global however it is an assessment of the design and sustainability of system, not an assessment on pensions levels and adequacy. The latest Allianz Pension Index which is designed to comprehensively analyse pension systems in terms of sustainability and adequacy ranks Latvia 13th out of 70 countries (based on the latest available data as of March 2020). The pension system is poorly rated when it comes to the question whether they provide an adequate standard of living in old age (2.99 out of 7 in case of Latvia)

2 - from the Soviet Union to the free market economy

With the financial support of the European Union
Part of the responsibility lies with the workers themselves. The high share of the shadow economy and informal employment significantly reduce the chances of receiving a decent pension in old age. Awareness-raising activities are essential, both in the context of the informal economy and general understanding of the contributions made and the expected pension, given that information should go to the consumer and not the other way around.

The Country Context

The ratings of the insurance company Allianz in its "Pension Sustainability Index 2016" reports contradict the findings of the German independent foundation Bertelsmann Stiftung in the project Sustainable Governance Indicators. The latter evaluates 41 OECD countries and all EU member states on a 10-point scale and fiscal sustainability with the question to what extent does pension policy realize goals of poverty prevention, intergenerational equity and fiscal sustainability? The Latvian pension system was given 4 points. This means that pension policy only partly achieves the objectives. This time the Estonian and Lithuanian pension systems are rated with 7 points (Bertelsmann Stiftung, 2018). Furthermore, the Senior Citizen Poverty is rated at 1 point, whereas the highest score relates to older employment with 7.3 points.

Latvia has had a three-pillar pension system since July 2001. It was designed to ensure that every worker is responsible for their old age and have sufficient security throughout their working lives. The pension system includes:

- **1st pension level** (state mandatory unfunded pension scheme), covering all payers of social insurance contribution. The contributions made are used to pay old-age pensions to the current generation of pensioners.
- **2nd pension level** (state mandatory funded pension scheme), the social insurance contributions are invested in the financial market through a fund manager of their choice and allocated to the pension of the specific contributor/tax payer.
- **3rd pension level** (private voluntary pension scheme), provides an opportunity for each individual to create additional savings for their pension in private pension funds of their choice.

1st and 2nd levels of the pension system are mandatory, while level 3 is voluntary, consisting of personal and workplace contributions. The main principle of the system is that the higher social contributions are made today, the higher the pension will be tomorrow.

The 1st pension level was introduced in January 1996. This includes the principles of intergenerational and gender solidarity. Intergenerational solidarity means that workers' social security contributions are used to pay old-age pensions of the current generation of pensioners.

Gender solidarity, on the other hand, means that women and men have had the same pension payment period since 1992, and the retirement age is the same for both women and men. The pension system is individualised, i.e. each person has his or her own SSIA account for accumulating and managing contributions. However, this does not mean equal pensions for men and women.

The 1st pension level system provides pensions to all those who have been socially insured for at least 15 years. If a person’s insurance period is less than 15 years, he or she is granted a state social security benefit. The minimum length of service required in order to have a pension has changed over time. When the pension system was introduced in Latvia, the minimum length of service was set at 10 years.

---

Due to the economic crisis, the minimum length of service was increased to 20 years in 2012, with the provision that from 1 January 2014 to 31 December 2024, the minimum insurance period is 15 years.

With regard to the retirement age, the latest reform of Latvian pensions system was carried out in 2014, this is when a gradual increase in retirement age was set from 62 to 65 (to be reached in 2025). Initially, the retirement age was 55 for women and 60 for men, in 1995 it was then raised to 62, closing the gender gap in terms of retirement age.

There is currently no discussion on raising the retirement age, and no review are expected, at least until 2025, when the previous reform will be fully implemented. The OECD assumes, in the context of wider discussions, that the retirement age may need to be raised above 65 by 2060, based on life expectancy. In general, the retirement age is not only affected by the sustainability of the social budget, but also by working conditions, lifestyle, medical technology and the quality and availability of health care (OECD, 2018). These are system improvements that should be taken into account when calculating life expectancy. However, as the current retirement age is maintained, the pension replacement rate will gradually decrease, i.e. the average pension versus past earnings will decrease as the number of employees decreases, while the life expectancy directly used in the pension calculation will increase with a corresponding reduction. This reduces pension perspectives for new entrants to the labour market. The replacement ratio is the same for both high-wage earners and those who have received half the average wage during their working life (OECD, 2018). The methodology for calculating Latvian pensions and the conditions for making contributions do not envisage some progressivity between large and small pension recipients.

It is important that upon reaching retirement age and continuing to work, a person receives a full pension. According to the data of the Central Statistical Bureau, in the 2nd quarter of 2020, there were 39.5 thousand employees in the 65-74 age bracket. We can provisionally estimate that about 10% of all old-age pension recipients still work. A survey conducted by the research centre SKDS also found that only 10.6% of pensioner respondents (15.8% of men and 8% of women) continued to work (SKDS, 2020). Although no representative data is available about the willingness and readiness of seniors to work, data from individual surveys show that Latvian seniors want to get involved in the labour market and be useful to society. Half of seniors (52%) who have reached retirement age or have just started to retire would like to enter the labour market. The main motivation is to earn extra money (35%), as well as to be with people and socialise (19%).

Retirement before the due time

Latvian legislation provides for the possibility of early retirement, two years before the actual retirement age. Taking into account that the retirement age is increased every year (from January 1, 2014 the real retirement age is increased by three months every year – until it reaches 65 in January 1, 2025), the age at which early retirement is possible increases accordingly. This means that early retirement in 2025 will be possible upon reaching 63 years. However, in order to be able to retire early, the paid insurance period must be at least 30 years.

There are restrictions on the payment of an early retirement pension until the actual retirement age is reached:

6. - Ibid.
• who are not working and who have been granted an early old-age pension paid 50% of the amount of the granted pension;
• for persons who have been granted an early old-age pension early, and enter employment (employed or self-employed), the early old-age pension is suspended.

An early retirement pension equates to 50% of the calculated old-age pension, upon reaching the actual retirement age, a person is then paid a pension in full, that is 100% of the calculated old-age pension. When a person retires before the due time, he or she must take into account that the old-age pension will be lower, because fewer years of social contributions are paid. Consequently, the number of people who choose to retire early is low, in 2018 only 13.7% retired before the due time.

The economic crisis affected the same early retirement pensions that were supposed to be one of the option how to ensure social security in a time of reduced employment activity. The amount granted with early pensions was reduced to 50% of the granted old age pension during the crisis in 2009. It was 80% prior to the crisis.

Among other things, the Latvian Pensioners' Federation has proposed that early retirement for parents with children be five years prior the general retirement age, and the amount of the pension should be 70% instead of the current 50%. According to the Pensioners' Federation, this would provide positive support for parents with children and could contribute to the improvement of the demographic situation.

It is also necessary to address the issue of pensions for those people who have once worked under severe and harmful working conditions, resulting in early retirement. Consequently, their length of period of insurance payment, and pension, are lower (however, they do not lose 50% of the amount of pension granted by early retirement).

Minimum old-age pension

The state has set a minimum amount of old-age pension, which depends on a person's length of service. Until 2020, the minimum amount of the old-age pension was linked to the state social security benefit. It should be noted that 2020 is the first year when the minimum amount of the old-age pension was increased after a long break. The last time the state social security benefit was increased was in 2006, from 35 lats (49.80 euro) to 45 lats (64.03 euro), hence the minimum old-age pension remained unchanged for 14 years. Although in 2020 the minimum old-age pension (decoupling it from the state social security benefit) has been increased from 64.03 euro to 88 euro (with length of service up to 20 years), the average net salary in the country during the period from 2006 to 2019, has increased more than 2.5 times, from 308 euro in 2006 to 793 euro in 2019.

Persons who have been granted an old-age pension shall not receive a pension that is less than the amount of the minimum old-age pension. One of the recommendations of the European Commission in 2019 was to undertake social exclusion reduction, notably by improving the adequacy of minimum income benefits, minimum old-age pensions and income support for people with disabilities (CSR, 2019). However, according to experts, Country Specific Recommendations have low conditionality on pension adequacy, this is also the case in Latvia (ETUC, 2019).

Although the minimum amount of the old-age pension has been decoupled from the state social security benefit in 2020, the state social security benefit is still granted to a person who is not entitled to a state pension. In most cases, this happens when a person does not have sufficient length of service, even if social insurance contributions have been paid.
Table 1

<table>
<thead>
<tr>
<th>Length of service</th>
<th>Coefficient</th>
<th>Minimum pension in euro up to 31.12.2019</th>
<th>Minimum pension in euro from 01.01.2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 20 years</td>
<td>1.1</td>
<td>70.43</td>
<td>88.00</td>
</tr>
<tr>
<td>From 20 to 30 years</td>
<td>1.3</td>
<td>83.24</td>
<td>104.00</td>
</tr>
<tr>
<td>From 31 to 40 years</td>
<td>1.5</td>
<td>96.05</td>
<td>120.00</td>
</tr>
<tr>
<td>41 and more years</td>
<td>1.7</td>
<td>108.85</td>
<td>136.00</td>
</tr>
</tbody>
</table>

https://www.vsaa.gov.lv/pakalpojumi/pensionariemsenioriem/vecuma-pensija/

In June 2020, 446,051 pensioners received an old-age pension, while 19,496 persons received a state social security benefit.

**Indexation of pension**

According to the Law on State Pensions, pension indexation takes place every year on October 1 (after the crisis period, salary increases were not taken into account in the calculation). The coefficient used for the indexation of pensions is done by using the actual consumer price index of the country and a part of the real increase in the amount of insurance contribution wages. However, the law stipulates that the amount of the state pension or its part, which does not exceed half of the previous year’s average insurance contribution salary in the country, is indexed.

From 2017, this part of the real increase in the amount of insurance contribution salaries is 50 percent (previously 25%). The purpose of pension indexation is to ensure the protection of granted pensions and benefits against a decrease in purchasing power and to ensure that their value is not lost. Consequently, pensions are growing faster than the consumer price index or prices, but less than the average wage in the country, because the average wage has been growing faster than the consumer price index since the economic crisis (since 2011 the consumer price index has increased by 1.8% on average while the average wage growth rate since 2011 has been 4.7% per year).

The indexation shall be based on the amount of the pension granted, excluding the amount of the supplement to the pension for insurance before 1996.

Various indexes depending on the length of insurance (valid since 2018) are applied in the indexation of old-age pensions. The longer the insurance period, the higher the index will be applied. Thus, in 2020, the minimum index is 1.0380, the highest is 1.0578.

<table>
<thead>
<tr>
<th>Length of service</th>
<th>Index</th>
<th>Real increase in insurance contribution salary</th>
<th>Pension increase *</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 20 years</td>
<td>1.0380</td>
<td>50%</td>
<td>363.30</td>
</tr>
<tr>
<td>From 20 to 30 years</td>
<td>1.0446</td>
<td>60%</td>
<td>365.61</td>
</tr>
<tr>
<td>From 31 to 40 years</td>
<td>1.0512</td>
<td>70%</td>
<td>367.92</td>
</tr>
<tr>
<td>41 and more years</td>
<td>1.0578</td>
<td>80%</td>
<td>370.23</td>
</tr>
</tbody>
</table>

---

8 - Par pensiju indeksāciju 2020.gadā (On indexation of pensions in 2020).  

9 - Kas ir jāzina par pensiju indeksāciju. Labklājības ministrijas skaidrojums. (What you need to know about pension indexation. Explanation of the Ministry of Welfare)  

With the financial support of the European Union
* - Example if the pension is 350 euro

Such an indexation procedure ensures the indexation of the entire pension for persons with low income, while for persons with relatively high income the indexation would be of part of the pension. On October 1, 2020, the indexation of pensions and benefits will take place and the amount of pensions and benefits or their parts not exceeding 454 euro will be increased. It should be noted that if the pensioner’s pension is more than 454 euro, then the part of the pension in the amount of 454 euro will be indexed, which is 18% higher than the average pension in June 2020. In 2020, the indexation will also be applied to old-age and invalidity pension supplements for one year of insurance accrued before 31 December 1995. However, personal income tax is deducted from the total amount of the pension and supplement (progressive personal income tax was introduced in Latvia in 2018, personal income tax for income and pension with supplements up to 1667 euro per month was reduced from 23% to 20%).

With the rapid increase in the average wage in recent years, the amount of pension, or share, up to which pensions are indexed is also increasing. For example, in 2015, pensions, or part thereof, amounting to 311 euro were indexed, which was 6.5% higher than the average pension in October 2015.

Although the indexation of pensions takes into account an increase of the average wage in the country, the indexation takes place the following year, moreover, only once a year for the previous period when inflation has already taken place. There is a view among pensioners that pension indexation should take place twice a year.

However, there is no consensus among pensioners on whether the indexation of pensions is fair and equitable for all pensioners. One of the cornerstones of the social security system is to close the gap between small and large pension recipients, but in the case of pension indexation, the biggest beneficiaries will be those who already have higher pensions. On the one hand, such indexation of pensions is fair, as those who have invested more work in the past, i.e. those who have worked longer instead of studying or family time, will receive more. A longer length of service also means that the person has worked legally, i.e. he/she has paid part of his/her salary in taxes, so he/she should receive a higher pension.

Equal indexation of benefits and pension supplement would not promote the credibility of the social security system and the need to pay taxes on the entire salary, including the strive for a better working life after higher income. On the other hand, a possible increase in pensions should be expressed in absolute terms in euro for each year of service and not as a percentage of the pension, as part of the accrued pension capital and seniority relates to the previous pension scheme.

**Impact of unemployment and child-care on pensions**

The resources of the special employment budget consist of compulsory contributions for unemployment insurance and other income. The insurance period also consists of the period when the insured person receives unemployment benefits. In case of unemployment, mandatory contributions to the pension insurance amounting to 20% of the unemployment benefit are made from the special employment budget for the unemployed person, but only for those who receive unemployment benefit. Recipients of unemployment benefits are insured by the state. The average duration of unemployment in June 2020 was 144 days (average number of days registered, median), compared to 173 days a year earlier, in total there are 5 to 6 months of unemployment (SEA, 2020).

---

In addition, the average duration of unemployment has decreased this year, the amount and duration of unemployment benefit were reduced starting from 2020. In turn, the average duration of long-term unemployment in June 2020 was 817 days, more than 2.2 years (1,027 days a year earlier). At the end of June 2020, there were 13,950 long-term unemployed registered with the SEA, which is 17.8% of the total number of registered unemployed. 58.9% of the total long-term unemployed were 50 years and over.

Given that the duration of the unemployment benefit is eight months, there is a direct negative impact of unemployment on the size of the pension in the future for the long-term unemployed, i.e. the average long-term unemployed loses around 20 months or just over 1.5 years of pension savings. In addition, the number of years during which no contributions to the pension capital are made increases if an employee who was previously long-term unemployed loses his job again.

Taking into account that the mandatory pension insurance contributions amount to 20% of the unemployment benefit, the employee's social insurance contributions, in case of unemployment lasting 6 months, are 50-60% lower than if the employee would work (calculations have been made taking into account the average gross salary in March 2020 with the insurance period from 10 to 19 years). The period of unemployment provides a certain social security safety in the case of pensions, although the period of unemployment prolongs the length of service during which one of the periods has paid lower social security contributions.

The same applies to sickness (20% of sickness benefit is made for the pension insurance). It means that higher pension insurance contributions are made during sickness (as sickness benefit is higher than unemployment benefit).

According to the Law on State Pensions, the insurance period for the pension also includes the time to take care of a child until he or she reaches the age of one and a half years. The parent who has cared for five or more children or child with a disability for at least eight years can retire five years earlier than the national retirement age, if the insurance period is not less than 25 years. While a woman is on parental leave, the state pays social insurance contributions for her at both 1st and 2nd level of pensions, at 14% and 6% respectively. These contributions are calculated from the childcare benefit, which in 2020 is 171 euro for a person who takes care of a child under the age of one and a half years. Childcare benefit is a state benefit that can be received by both parents who are socially insured and those who are not employed or self-employed. In 2020, the amount of the benefit is 171 euro for a person caring for a child under one and a half years of age, and 42.69 euro for a child between one and a half and two years of age.11

However, social contributions are not calculated from parental benefit. At present, a minimum of 15 years of insurance is required to receive a pension, even if a woman has 3 children. Pension insurance contributions amounting to 20% of 171 euro are made by the state, in addition to the childcare benefit. Taking into account the same conditions as in the case of unemployment insurance, during the one and a half years a new mother spends raising her child, the new mother pays on average 85% less pension insurance contributions than if the new mother had worked.

In addition, the new mother can make contributions to the 3rd pension level (private pension scheme). Contributions to the 3rd pension level can be made by everyone at their own discretion and possibilities, i.e. the amount and regularity of contributions are not determined. However, parental benefit is not subject to personal income tax. This means that for the period during which the Parental...
benefit is received, a woman will not be able to receive a tax refund for the contributions made at the 3rd pension level.

Among all types of social insurance, the self-employed mandatory contributions for parental insurance is the lowest among the different types of insurance, however there is a tendency to increase the mandatory contributions shortly before maternity leave to receive as high a benefit as possible (Baltijas Konsultācijas, Consort, 2018). Thus, the importance of insurance increases before the needs of each specific group approaches, for example, in the age group 25-34 parental insurance is more important, while pension insurance is important for people of pre-retirement age in the age group 51-64.

**Service pensions in Latvia**

Service pensions provide an opportunity to retire long before the general retirement age and receive a pension, the amount of which does not depend on the accumulated pension capital. There are different criteria for awarding service pensions as regards the age at which one is entitled to a service pension.

For example, the minimum retirement age for the State Emergency Medical Service staff and diplomats is 55 years. Military persons are entitled to a service pension as one of the conditions if the military person has started service after 1 January 2005 and has continuously served, including compulsory active military service in the Armed Forces of the Republic of Latvia, for 15 years and retired. Prosecutors are entitled to a service pension if the length of service is at least 20 years, of which the last 10 years have been served as a prosecutor, and who has reached the age of 50. Ballet artists are entitled to a retirement pension after 18 years of service, soloists, vocalists and circus artists, after 20 years of service, choir artists after 25 years, etc.

In 2020, for the first time, state institutions have included in their annual reports estimates of liabilities to recipients of service pensions, which the state has undertaken over the years. This has allowed the State Audit Office to calculate and announce in the spring of 2020 that the state's future liabilities have reached at least 4.5 billion euro. In the opinion of the State Audit Office, with the development of such a situation, without reviewing the existing service pensions or continuing to expand the range of their recipients, future retirement pensions may become an almost unbearable burden on the state budget.\(^\text{12}\)

Although the State Audit Office has expressed concerns about increasing expenditures on service pensions, the number of recipients has not changed significantly over the last ten years. According to data of the State Social Insurance Agency, in June 2020, 10,963 persons received a service pension, which is only 2.4% of the total number of pensioners. In comparison, in June 2011, 10,206 persons received service pensions. However, in Latvia the range of professions in which employees are entitled to apply for a service pension has gradually expanded.

Compared to the pre-crisis period, in June 2008 only 3,296 persons received service pensions. The average amount of the service pension has increased from 192.09 euro in June 2008 to 535.69 euro in June 2020. However, the average does not fully describe the situation with regard to the size of service pensions. Thus, employees of the internal and commanding staff of internal affairs institutions receive the most service pensions and their average service pension in September 2018 was only 420.48 euro.

\(^\text{12}\) - The State Audit Office website [www.lrvk.gov.lv](http://www.lrvk.gov.lv)
Although the general retirement age is gradually increasing, the age required for service pension is not revised in any of the occupational groups.

The OECD has recommended that service pensions should be reintroduced into the main pension scheme, as almost 40% of these pension recipients are under the age of 50 and most of them combine work with receiving a pension (OECD, 2018). The Saeima Analytical Service has conducted a study on the practice of special pension rights in Europe. In its research it concluded that out of 10716 recipients of service pensions, who were registered in September 2018, 6606 persons (62%) were employed in the period from January to September 2018 (Saeimas analītiskais dienests, 2019). According to the Central Statistical Bureau data, in 2019 people aged 45 to 54 where the recipients of most retirement pensions (3.6 thousand or 0.8% of the total number of pensioners), followed by persons aged 55 to 59 (3.1 thousand or 0.7% of the total number of pensioners).

The OECD has indicated in its study that a person has the opportunity to retrain. However, there are a number of important counter-arguments. First, as the Constitutional Court has acknowledged, “a person who retires shortly before reaching the general retirement age must ensure an adequate subsistence pension, because the probability that a person will retrain at this age is minimal” (Constitutional Court, 2007). Secondly, the labour market in Latvia cannot offer unlimited employment opportunities in accordance with previously earned income, working conditions etc.

The President of the Free Trade Union Confederation of Latvia Egils Balzēns states that trade unions believe the service pension system must be improved, but emphasises that it must be assessed from a different point of view. Trade unions would be ready to start a debate on service pensions – whether or not a change in the service pension system is needed, only when they see substantial increase in wages and social guarantees. According to the unions, the main problem is that employees do not receive a decent salary and social guarantees, and this is the responsibility of the state (LBAS Vēstis, 2020). Wages and social guarantees must be such that there is no need for so-called deferred payment of wages (non-official term for service pensions). Thus, for example, the average salary of a firefighter in May 2020 was 6.21 euro per hour or an average of 944 euro per month, which is less than the average salary in the country, the ballet dancer received a little more on average – 7.14 euro per hour, but the average number of hours worked per month was lower (on average it did not reach full work load – regular working time per week).

The trade union of Latvian Interior employees (LIDA) emphasises that the services of the Home Affairs system are currently facing not only difficulties in attracting new staff, but also problems related to the retention of new employees. Many officials leave the service before reaching the set minimum length of service for receiving a service pension (LBAS Vēstis, 2020).

In order to assess the long-term budgetary impact of service pensions, it is more important to look at the part of the service pension budget allocated annually, which is EUR 53.9 million for 2020. The budget foresees 2.35 billion euro for old-age pensions for 2020, which means that the expenditures for long-service pensions (but in most cases they are paid from the state basic budget) are equal to 2.30% of the total pension budget.

**The Challenge of non-standard employment and self-employment**

In 2019, there were 1,105,626 socially insured persons, including persons who are not formally active in the labour market. The average contribution salary of socially insured persons in 2019 was 908.89 euro.
If a person is insured for all types of social insurance, the rate of mandatory state social insurance contributions is 35.09% (in 2020), of which 24.09% is paid by the employer and 11% by the employee. 1% of the total mandatory contribution rate is used to finance health care services.

In the case of employees who fall under the general tax regime, 20% of the overall social insurance contributions (35.09%) goes towards pension insurance. The wide range of gainfully occupied persons are subject to compulsorily social insurance, these include the self-employed and anyone registered as an employee of a micro-enterprise. However, the rate of social insurance contributions and the insured cases against which a member of the social insurance system is insured differ. Traditionally, the self-employed and micro-enterprise employees (there are several other categories of employees as patent payers, agricultural workers outside the general tax regime) are considered as non-standard employees and the most vulnerable from the point of view of social security.

In the case of self-employed people whose monthly income does not reach the amount of the minimum wage, 5% of this income must be paid to the State Social Insurance Agency for pension insurance (in 2020).

When the monthly income of a self-employed person reaches and exceeds the minimum wage, they must pay the social taxes equivalent to that of the minimum wage (the rate for social insurance contributions for the self-employed is generally 32.15%) and 5% of the difference between the minimum wage and the income must be paid for pension insurance.

In turn, the object of mandatory contributions for a micro-enterprise employee is calculated according to the amount of mandatory contributions (80% of the micro-enterprise tax amount), in proportion to the number of employees each month and the actual income of employees, applying the relevant mandatory contribution rate.

In the case of a micro-enterprise, there are a number of fiscal conditions in terms of turnover, number of employees and wages.

More specifically, the micro-taxpayer (introduced in 2010 as a crisis solution) pays 15% of income in the case of a natural person, of which 80% is transferred to the state social insurance mandatory contribution account and 20% is transferred to the personal income tax account. This means that if the micro-taxpayer’s quarterly income is 10,000 euro, the number of employees is 4 and the employee’s salary is 720 euro, then social security contributions amounting to 100 euro are paid for each employee (mandatory contribution rate 34.09%), which would correspond to a gross salary of 293.40 euro. By comparison, under the general tax regime, social security contributions from 720 euro would have been paid at 245.45 euro, i.e. 2.5 times higher. In 2019, 56,883 employees with an average salary of 530 euro received a salary under the micro-tax regime. This means that the micro-taxpayers and self-employed do not have significant pension capital and are often not even aware of it.

This was most evident during the COVID-19 pandemic, when social security contributions paid by the self-employed proved insufficient to qualify them for the allowance related to idle time, i.e. as of 11 May 2020, the allowance for idle time was refused in 40% of self-employed applications. In case of 54% of the self-employed who applied for the allowance for idle time but were refused, on average declared less than 20 euro of mandatory state social insurance contributions per month before COVID-19 pandemic.14

---

13 - The State Revenue Service website [www.vid.gov.lv](http://www.vid.gov.lv)
14 - ibid.

With the financial support of the European Union
According to SSIA data, 90% of the self-employed pay around 201-400 euro in contributions from their salary. However, the issues do not lay solely with employment and social security policy. A study conducted two years ago argues that the self-employed are not associated with the highest mandatory contribution, especially in relation to receiving an adequate retirement pension (Baltijas Konsultācijas, Konsorts, 2018). According to experts, one of the reasons is low motivation and willingness to pay taxes, which is related to the prevailing disbelief in society in general to collect and use taxes in good faith (Baltijas Konsultācijas, Konsorts, 2018). The public is of the opinion that the state pension system cannot be relied on. According to the survey, only 53% of respondents (self-employed) believe that making mandatory contributions to pension insurance is important (Baltijas Konsultācijas, Konsorts, 2018). There is also a lack of awareness about the importance of mandatory contributions and social security in old age.

According to SSIA data, in the 1st quarter of 2020, 27,927 self-employed persons made social insurance contributions. However, it must be acknowledged that the social tax rate for the self-employed, which is only slightly lower than for those working under the general tax regime, is too high. Especially taking into account the specifics of self-employment.

The study on self-employment in Latvia concludes that self-employment is widely used both in Latvia and abroad to: start a business, integrate people with very low chances of finding paid employment into the labour market, provide an opportunity to seasonal workers, or illegally employed people, to join the social insurance system (Baltic Consulting, Consortium, 2018). This same study concluded that 35% of respondents (self-employed) work up to 30 hours a week on average, which also means proportionately a lower income, i.e., increasing average monthly income from self-employment increases weekly working hours and pension contributions (Baltic Consulting, Consortium, 2018). However, for a large part of the self-employed, working hours exceed normal daily and weekly working hours. On average, 19.5% of all employees in Latvia worked less than full-time (from 0-39 hours per week). Holiday work is typical of the majority of the self-employed (33% of respondents work almost every weekend), but unlike those working under the general tax regime, the self-employed have limited opportunity to granting himself or herself a day of rest on another day of the week for working on Sundays as it would normally be the case.

Therefore, in order to start a business and integrate a person into the social security system, a minimum threshold for insurance contributions with a reduced tax regime should be set.

Although it is the responsibility of every self-employed person to familiarise themselves with social security services, the right to receive them and future prospects, it should be noted that access to information is complicated and not everyone can calculate their future pension. In addition, to calculate the potential pension, it is necessary to know the savings in the 1st and 2nd level of pensions. Despite the fact that the information is electronically available to everyone when logging in to the public service website, not everyone searches and spends time performing calculations. In addition, the general level of awareness of social security services and types of taxes is low.

In general, the self-employed are satisfied with the chosen form of employment. According to results of the survey, 78% of respondents indicate that they are satisfied (fairly satisfied or very satisfied) to work as self-employed. Satisfaction with working as a self-employed person is mostly determined by factors such as freedom of initiative and personal independence, as well as the opportunity to create good and safe working conditions and an orderly working environment.

The willingness to pay taxes increases with education, but this would rather be explained by the fact that the type of occupation and/or industry changes with higher level of education. The amount of undeclared salaries in 2019 was 22.3% (the average share of salaries in percentage, which
entrepreneurs actually pay, but hide from the state), the largest share of the shadow economy is in the construction sector – 33.3% (SSE Riga, 2020). Although high labour taxes are traditionally cited as the main reason for under declaring salaries, employers also cite procurement policy as a reason, as the “economic benefit” is assessed, i.e., in order to win in tenders, the price is reduced directly at the expense of labour, or rather at the expense of labour taxes (Sauka, 2020). This means lower social security contributions and a significant impact on future pensions.

The OECD has calculated that in order to receive the minimum pension, it is enough to work for 18 years with the minimum wage (OECD, 2018). This means that the material security of those who receive the minimum wage will be very low in old age. According to the Central Statistical Bureau data, 18.9% received the minimum wage or less in 2019.

Furthermore, reducing the informal economy and increasing social budget revenues would allow existing pensions to be indexed more rapidly. For people currently working in the informal economy or in micro-enterprises, future pensions are likely to be very small, thus exposing them to the additional risk of poverty in old age. The European Commission also emphasises, in its recommendations, that undeclared work and underdeclared wages remain widespread, weakening workers’ social protection (CSR, 2020).

In order to reduce the shadow economy, on November 3, 2019, the general agreement of the construction sector came into force. This determines the minimum wage in the construction sector at 780 euro (the national minimum wage in 2019 was 430 euro), as well as a mandatory 5% bonus if the employee has acquired qualification appropriate to the profession.

As for the low-skilled, they are paid low salaries and this results in lower pension. According to Eurostat, those with upper secondary and post-secondary non-tertiary education receive 37% less than those with short-cycle tertiary education and bachelor’s or equivalent level (in Latvia). Trade unions therefore emphasise the role of education and training in improving social coverage and adequacy.

**Demography as challenge and healthy life expectancy**

Although the number of pensioners has not increased significantly over the last ten years, the demographic burden (the ratio of the number of people under and over the working age in proportion to the number of people of working age) is expected to increase as the number of the economically active population decreases. Thus, the demographic burden has increased from 545 persons under and above working age per 1,000 persons of working age in 2010 to 643 persons per 1,000 persons of working age in 2020.

Until 2020, this can be explained by the decrease in the number of economically active population, part of which is the negative consequences of migration, when part of the labour force migrated abroad as a result of the consequences of the economic crisis. In addition, the population below working age has not changed over the last ten years (300,294 persons in 2010 and 305,188 persons in 2020). However, the birth rate is unsatisfactory, i.e., an average of 18 to 20 thousand births per year (with the exception of 2008, when 24,397 children were born), which is insufficient to ensure positive natural population growth. As the workforce shrinks, the internal revenue of the unfunded contribution scheme, which is based on the principle of intergenerational solidarity, decreases.
The employment rate in Latvia in the 4th quarter of 2019, pre-covid, exceeded the EU-28 average (employment rate for 15-64 year olds in Latvia was 72.7%, while in the EU-28 it was 69.5%), labour reserves were and are limited. Although emigration has decreased in recent years, the net migration rate is still negative and most of the people of working age who leave Latvia would otherwise have made social contributions to pay pensions to current pensioners.

Labour market policy is an additional element in the context of an aging workforce, as employers try to find ways to make the labour market more accessible to third-country nationals and in some cases, they succeed (trade unions tend are opposed policies regarding the migrant workers since they are not adequate).

However, productivity growth must also be taken into account. Thus, the Ministry of Economics predicts that economic growth in the coming years will continue to be largely based on productivity growth. In addition, more and more labour needs are offset by productivity gains, which means that less employees are needed to perform certain jobs (EM, 2020). Productivity can also contribute to wage growth, which in turn has a direct impact on pension capital growth.

However, productivity is largely dependent on investment in technological advancement and innovation, as well as on access to international trade, not only on labour cost. In Latvia investment in R&D is very low, according to Eurostat in 2018 expenditure on R&D in Latvia, as part of GDP, was the third lowest among EU countries or 0.64% of GDP, compared to EU-27 average 2.18%.

On a macroeconomic scale productivity in Latvia is also limited due to its economic structure with relatively low share of goods and services with high added value. The structure of economic activity is predominantly based on domestic services, almost 74% of GDP is based on economic activity in services sector while only one third of exports are services. In the last years a growing proportion of exported services come from ICT and other economic activity support services sectors, however still the largest share is held by transport and tourism services, which have a limited capacity of productivity growth.

Taking into account demographic forecasts, as well as the expected increase in life expectancy, the European Commission forecasts a significant increase in the old age dependency rate in the long run - from 33.1% in 2020 (forecast) to 65.2% in 2060, slightly decreasing to 53.8% in 2070 (European Commission, 2020).

With the financial support of the European Union
With the financial support of the European Union (2017). The expected increase in retirement years is related to the increase in life expectancy, with the retirement age remaining unchanged (see Figure 2).

Figure 2. Duration of retirement, prognosis

[Duration of retirement, prognosis, years]


Demographers believe that the average life expectancy at birth is the most appropriate indicator. In 2010 the life expectancy of new-borns was 73.1 years (77.9 years for women and 67.9 years for men), whereas in 2019 the life expectancy of new-borns was 75.6 years (79.9 years for women and 70.8 years for men). In turn, the life expectancy of the 40-year-old population (as of 2019) is 77.3 years (81.1 years for women and 72.9 years for men). Currently (in 2020) the retirement age is 63 years and 9 months. This means that the life expectancy of new-borns after retirement will be 9 years for men and 17.2 years for women.

However, the most important indicator in determining the retirement age is healthy life expectancy, the specialists believe that ignoring healthy life expectancy can lead to very low returns to the labour market and social problems. According to the World Health Organisation and the World Development Indicators, the average healthy life expectancy in Latvia is 66.2 years (62.4 years for men and 69.5 years for women). However, when assessing the actual healthy life expectancy in 2018, according to Eurostat data, it was 52.3 years (53.7 years for women and 51 years for men). One of the risk factors that reduces healthy life expectancy is low income as well as low education. Accordingly, older people have limited opportunities to work, which determines their retirement age. Healthy life expectancy is an average that includes varying lengths of healthy life. Unfortunately, there is no available indicator of the distribution of healthy life expectancy.

According to the Central Statistical Bureau, 51.6% of seniors aged 65 and over are burdened with the cost of medicines (prescribed and non-prescribed). Amongst the EU member states, Latvia, together with Lithuania, has the lowest percentage of the population aged 65 and over who assess their health status as very good. Self-reported unmet needs for medical care at age 65 and over is the third highest among EU Member States in 2018 (after Greece and Romania), with a total of 5.6% reporting unmet needs for medical care.

---

15 - The World Health Organisation. [https://apps.who.int/gho/data/view.main.HALEXv](https://apps.who.int/gho/data/view.main.HALEXv)
needs for medical care, it should be noted that the rate has fallen significantly in recent years (in 2010 it was 15.9%). This is a common problem of the system and does not apply only to seniors in the age group 65 and over; in 2018 in the age group 45-54 years the same indicator was 5.5%, similar to the age group 65 and over.

**Inadequate pensions as a challenge**

The average pension in Latvia in June 2020 was 384.71 euro, in June 2019 it was 352.79 euro. As stated by the European Commission, Latvia faces challenges on delivering on several social protection and inclusion principles of the European Pillar of Social Rights (CSR, 2019).

### Average size of pensions paid and average size of newly granted old-age pensions, 2nd quarter, euro

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average pension</td>
<td>272.42</td>
<td>286.58</td>
<td>306.70</td>
<td>333.17</td>
<td>363.38</td>
</tr>
<tr>
<td>Newly granted old-age pension</td>
<td>315.90</td>
<td>324.25</td>
<td>349.08</td>
<td>373.67</td>
<td>421.28</td>
</tr>
<tr>
<td>Average work salary, net</td>
<td>627</td>
<td>676</td>
<td>744</td>
<td>793</td>
<td>-</td>
</tr>
<tr>
<td>Average salary from which contributions are made</td>
<td>698.64</td>
<td>764.42</td>
<td>839.13</td>
<td>908.89</td>
<td>-</td>
</tr>
<tr>
<td>Pension from average salary, net</td>
<td>43.45</td>
<td>42.40</td>
<td>41.23</td>
<td>42.02</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: The Central Statistical Bureau. SD010c. Number of pensioners and the average size of the monthly old-age pension by Year/Quarter and Indicator

The amount of a pension is determined by three factors – the person's accrued contributions to the pension capital during employment, the rate of return on capital, and life expectancy at retirement. The average amount of newly granted pensions is increasing every year, as the share of insurance periods before 1996, when the Pension Law came into force, is decreasing.

In the case of people who pay social insurance after 1 January 1996, the old-age pension is determined by taking into account the accumulated pension capital in the period from 1996 to the month of granting the pension and the retirement age. During the transition period, a major challenge was to determine the accumulated pension capital before 1996, when social insurance contributions were not personified. The system of individual accounts was introduced with the pension reform in 1996.

For persons with insurance payment done before 1996, the initial pension capital is also determined, it is calculated for a period when the average salary was very low (the average salary in 1996 was 140 euro, the minimum salary was 54.07 euro). However, insurance for seniority is crucial, i.e., for persons with at least 30 years of service, the 48-month average updated national insurance contribution salary is taken into account (if the person's salary from 1996 to 1999 was lower than the national average).
If the insurance period is less than 30 years, another condition is met. Taking into account that until the entry of new pensioners into the pension system, the proportion of pensioners who have worked up to 31 December 1995 will decrease, thus the pension prospects are better.

Although the average amount of newly granted pensions is increasing every year, the amount of pensions is below the at-risk-of-poverty rate. As household disposable incomes increase, so does the risk of poverty. Thus, in 2018, the at-risk-of-poverty rate was 409 euro per household member. For households with two adults and two children under the age of 14, the at-risk-of-poverty threshold in 2018 reached 860 euro per month.

Single pensioners are most at risk of poverty – 74.9% of 1 person household pensioners aged 65 and over are at risk of poverty, they are followed by the unemployed age group 18-64 years - 57.6% (of unemployed men aged 18-64 62.4%, women - 52.9% are at risk of poverty). On average, 53.8% of all pensioners are at risk of poverty, including 56.1% for women and 48.8% for men. The risk of poverty increases with age, 57.1% of pensioners in the age group 75 and over are at risk of poverty. In addition, there are marked differences between regions.

It is significant that in 2018, 80.5% of pensioners were exposed to the risk of poverty before making social transfers, but taking into account all social transfers, the proportion of pensioners at risk of poverty remains very high - 47.9% (the impact of social transfers on poverty and inequality reduction is limited – CSR, 2019). In addition, the impact of social benefits on the income of the population has been decreasing in recent years, in 2012, taking into account all social transfers, 17.6% of pensioners were at risk of poverty, this gradually increasing to 47.9% in 2018. It should be noted, however, that as the median household disposable income increases, so does the at-risk-of-poverty rate.

In recent years, the gap between the EU average and the Latvian average in work at risk of poverty rate has decreased. If in 2010 the in-work at risk of poverty in Latvia was slightly higher than the EU average, then in 2018 the same indicator is slightly below the EU average. This means that income from work is rising, and contributions to pension insurance are also rising.

The material deprivation index in the age group 65 and over has significantly decreased over the last ten years, from 60.6% in 2010 to 31.8% in 2019, but still remains high enough in both the age group 65 and over and the age group 16-64, the latter being 24.8% in 2019. However, this indicator is 7.1% among the population with a higher education. Material deprivation decreases with the level of education. Furthermore, there is no significant difference between cities and regions (in rural areas the indicator is slightly higher).

According to the Central Statistical Bureau, 70.50% of all pensioners received an old-age pension of up to 400 euro, which is below the poverty line (the poverty threshold was 409 euro in 2018). 14.4% of all pensioners received an old-age pension from 400.01 euro to 500 euro, 12.9% of all pensioners received an old-age pensions from 500.01 up to 1000 euro. Only 2.17% of all pensioners received pensions above 1000 euro. In comparison, minimum wage was 430 euro, but the average gross salary was 1076 euro (793 euro net per month) in 2019. Pensions are subject to personal income tax.

In 2016, the necessary 10,000 signatures were collected to submit an initiative to the Saeima, urging that personal income tax should not be applied to 1st level pensions paid by the state, but the Saeima has not yet made a decision on the initiative. The applicants justified the need for changes since in the European Union countries that have a level of development equivalent to Latvia – Lithuania, Bulgaria, Hungary and Slovakia – the first level of pensions is not subject to personal income tax. 17

---

17 - The Platform for Society Initiatives [www.manabalss.lv]
Although the non-taxable minimum pension should be discussed and raised, the exemption from income tax for all pensions is controversial. In 2020 the non-taxable pension amount is 300 euro, it is equal to the maximum non-taxable income for employees, in 2018 and 2019 the non-taxable minimum pension was higher than the latter. Taking into account that social contributions are the first to be paid out from a salary, from which the employee in turn creates a pension savings, and personal income tax is applied subsequently, this results in a part of the income that is not subject to personal income tax. Accordingly, upon retirement, income on which personal income tax was not paid must be done during the retirement years. Furthermore, it does not address the low income of small pensions, as the tax-free pension initiative does not apply to 30% of pensioners, i.e. the tax-free minimum for pensions is 300 euro. Trade unions supported the initiative.

One of the proposals of the Latvian Federation of Pensioners is to gradually increase the non-taxable minimum pension to the minimum wage (in 2020, this means that the non-taxable minimum pension should not be 300 euro, but 430 euro).

In order to reduce the risk of poverty and rapid loss of income in the event of the loss of a spouse's pensioner, significant changes in legislation were made in 2018, providing that from 1 January 2019, in the case of the death of a pension recipient, the surviving spouse, who is the recipient of the old-age, disability, service or special state pension, can receive an allowance equivalent to 50% of the pension granted to the deceased spouse for 12 months.

The future perspectives and possible reforms

Taking into account that the share of pensioners in Latvia is gradually increasing, but the number of employees will decrease in the future, experts predict that the amount of pensions against the average salary in the country will decrease significantly. Thus, at present, the pension replacement rate is about 40%. According to European Commission forecasts, life expectancy in 2050 for men will be 78.5 years, for women 85.7 years, and the population will be 1.5 million (European Commission, 2018).

Figure 3. Population prognosis in the age group 0-19 and 65 plus


While ensuring adequate social security in old age is a complex issue, one of the possible improvements to the system is to promote the employment of older people. Although in Latvia in the older age group 60 to 64 years, employment is above the average compared to the EU (71.6% in Latvia opposite 66.5% on average in the EU-27), the barrier to adequate employment in old age is the
reduction in income from paid work on average in the labour market together with age. According to data from Executive Search and Human Resource Management Company Fontes, the highest wages on the labour market are earned at the age 42-43, subsequently pay reduces with age (Fontes, 2020). This may also affect the size of the pension, since the pre-retirement period decreases in income and, consequently, pension insurance contributions.

Compared to other countries (Eurostat data for 2014), in only a few countries (Estonia, Latvia and Poland), the income of the age group 40-49 is 10% higher than the income of workers in the age group 50-59 (the sample consisted of companies employing more than 10 employees). Men receive 6.6% more than women (Fontes, 2020), but the lowest difference is seen among senior leaders, whereas the gap has declined significantly in recent years. According to data from the CSP, the difference between average gross salary for women and men in Q1 2020 was 15.7%.

The pay gap also results in pension inequality. In 2019, the average amount of paid pensions for women was 327.51 euro, while for men it was 327.51 euro, i.e., the average pension for women accounted for 90% of the average pension for men. In addition, the situation has not changed in the last ten years, in 2010 the pension for women accounted for 90% of the average pension for men, a slightly worse situation was observed in 2004 and 2005, when the amount of pension for women accounted for 85% of the pension for men. Lower pensions for women are associated with both shorter working lives and longer life expectancies. In fact, women are punished for living healthier lives and taking care of their health in the pre-retirement period.

Income inequality in Latvia is high. The Gini coefficient in Latvia, which indicates income inequality, is one of the highest in the EU, in 2018 the Gini coefficient was 35.2, the EU average was 30.9, only Bulgaria 39.6 and Lithuania 36.9 were worse than Latvia (CSB, 2020). However, pension inequality is lower than wages inequality, since of the amount of pension is smaller than in the case of wages.

**Sustainability of the pension budget**

The sustainability of the pension system is also reflected in expenditure on pensions and health as a percentage of GDP.

Figure 4. GDP growth billion, expenditure on pensions and health

*Forecast for 2020 in accordance with the report of the Ministry of Finance “On forecasts of macroeconomic indicators, revenue and general government budget balance in 2021-2023”*
Forecast of the Ministry of Health at the end of 2019

According to the European Commission, gross public pension expenditure will decrease significantly. If the current average is 8%, in 2060 it will be 5.6% and in 2070 4.7% (European Commission, 2017). This is mainly due to a redistributions between the social insurance scheme and the funded pension scheme, where the importance of pension capital accumulation at the 2nd pension level will increase over the years, and the substitutability coefficient of contributions from the 1st pension level will decrease.

The fact that there is insufficient funding for health care in Latvia has been emphasised by the World Health Organization, the European Commission and the OECD. Lack of funding significantly affects the poor health of the population as a whole, life expectancy, and inequality in access to services. Latvia has one of the highest rates (second highest after Estonia) of unmet medical care needs. In 2018, 11.1% of persons aged 16 and over reported they had unmet needs for medical examination or treatment, the EU-28 average was of 3.2%. There are a variety of reasons why needs for healthcare services are not met, for example because of cost (too expensive), distance (too far to travel) or timeliness (waiting lists), which makes it possible to identify causes of limitations in access to healthcare services (Eurostat definition). Budget spending on health care at 4.10% is almost half the EU-27 average, which is 7%, it is only Cyprus that has a lower total government expenditure than Latvia (2.7% of GDP in 2018).

According to the State Social Insurance Agency, at the end of 2019, the social budget had a savings of 1.12 billion euro. The expenditure on pensions in 2019 was equal to 2.15 billion euro and on unemployment benefits, 131.9 million euro. The revenue of the social budget in 2019 was 3.05 billion euro, and it was estimated that in one year there could be a saving of 299.5 million euro.

Trade unions role
Together with the government and the Latvian Employers’ Confederation, the Free Trade Union Confederation of Latvia (LBAS) works in the National Tripartite Cooperation Council (NTSP). Currently, 10 sub-councils are actively operating in the institutional system of the NTSP, these depend on the range of issues that need to be discussed. One of the sub-councils is the Social Security Tripartite Cooperation Sub-Council. Although the Sub-Council has a consultative role, it discusses all current social security issues. There are also several committees and councils in the field of social security, for example, Social Inclusion Policy Coordination Committee with wide range of actors, including the social partners.

Trade Unions participates in the development of economic and social development programmes, in the working groups related to the drafting of the laws, on improvement of working conditions, compulsory social insurance and social guaranties, healthcare as well as employment. However, all these groups have consultative role and all decisions made by social partners are not binding.

Trade unions have a moderate role to play. However, when it comes to pensions and possible changes in the pension system, trade unions demonstrate a more active role than in matters such as unemployment.

The role of trade unions can be compared to the opposition in government - you can have a say, but decisions are made by others. The same is true of the implementation of pension policy and the involvement of trade unions in it. Various low-impact consultative platforms are being set up. At the same time, the capacity of trade unions is not sufficient to reflect any changes in the field of social security. Consequently, organisations whose scope is directly relevant to the issue under

---


With the financial support of the European Union
consideration are gain prominence: in the field of pensions, they are organisations uniting pensioners, which also have a sufficiently strong voice.

**Pension supplements and different attitudes**

Pension supplements aim to reduce income inequality and increase pensions for those who have worked for up to 1996, that is for recipients of old-age pensions living in Latvia covering the insurance period until 31 December 1995. Therefore this applies to people who retired from 1 January 2006 to 31 December 2011 (if the insurance record is not less than 30 years).

The amount of the supplement for one year of insurance (work) is 1.07 euro (or 1.61 euro for each year of insurance until 31 December 1995, if the old-age pension was granted before 31 December 1996). Since 2019 in October of each year, pension supplements are also indexed together with pensions (in previous years, the supplement was 1 euro).

Both the Latvian Pensioners’ Federation and the Ombudsman have addressed the Social and Labour Affairs Committee of the Saeima, pointing out the injustice. Namely, pension supplements have been granted to 360.7 thousand pensioners, but not to 82.9 thousand (2019 data). Pension supplements for length of service until 31 December 1995 have not been granted to those pensioners who retired in 2012 and later. Such a decision was made in 2010 for the purpose of saving the social budget, setting 31 December 2011 as the deadline for granting the supplement. In 2013, the Constitutional Court acknowledged that the actions of the state and the legislator have been legitimate and the norm on pension supplements complies with the Constitution (Satversmes tiesa, 2013). However, even the Ombudsman acknowledged that the supplement is to be recognised as an additional social guarantee, therefore a person’s temporary right has been established. However, the Constitutional Court acknowledged that the possibility to amend the existing legal regulation is not excluded. The duty of the state in any economic situation is to ensure decent living conditions (Satversmes tiesa, 2013).

A senior working group has been set up to develop proposals for pension supplements. It should be noted that the number of pensioners who have years of insurance until 31 December 1995 is decreasing every year. For example, for those who retire this year (in 2020), two thirds of the insurance period is based on social insurance contributions (if the insurance period is 40 years), while the insurance period until 31 December 1995 is 16 years. In 2019, the Ministry of Welfare calculated the costs for various options, so, for example, if the supplement were granted to all pensioners, then an additional 85 million would be needed.19 The Senior Working Group supports the proposal to renew the allowances gradually, initially for two years (for those who retired in 2012 and 2013), with successive extensions to those who retired later. Although the supplement is an additional payment (rather than a mandatory one), it creates unequal treatment between those who retired in December 2011 and January 2012, given that all persons receiving a state old-age pension are in the same situation. In addition, the allowances do not affect social budget expenditure, as they are paid from the state basic budget. Another proposal would be to grant a pension supplement for pensions up to a certain level.

**Funded and private pension scheme as choice?**

The funded pension scheme was planned from 1996 and introduced in 2001. Although the total contribution rate for pension insurance did not change until 1996 and thereafter, there have been several redistributions between the unfunded pension scheme and the funded pension scheme, initially the distribution was 18% vs. 2%, later 12% vs. 8%, 15% vs. 5% in 2015, but since 2016, the year it is set at, 14% versus 6%. The OECD has acknowledged that commissions in the funded contribution

---

19 - calculations were made in 2019 for 2020 by the Ministry of Welfare

With the financial support of the European Union
scheme are high (OECD, 2018). This is also acknowledged by other experts. There is no maximum commission in voluntary private pension funds.

Upon retirement, members of the social insurance system who have made contributions to the 2nd pension level have two options – to add the capital accumulated in the funded pension scheme to the 1st pension level, i.e. to receive a larger pension, or to purchase a lifetime pension insurance policy for savings in the 2nd level. The European Commission Fiscal Sustainability Report 2012 concluded that the notional defined contribution system had low sustainability risks, given its expected reliance on funds raised through the second pillar.

In addition to funded and unfunded pension schemes, where both are mandatory, there are also voluntary pension funds, which were introduced in 1998. However, activity is low and the number of 3rd level pension participants is growing slowly. According to the Finance Latvia Association (FinanceLatvia) about 296 thousand people make up their savings at 3rd level (80% are individual members, 20% are company employees, for which contributions are made by employers). In Latvia in 2017, contributions to private pension funds were made for 55 thousand employees in 1,026 companies which is 6% of all employees in Latvia. The average contribution per participant per month was about 4-5% of the average gross monthly salary.

In the opinion of FinanceLatvia, this is not enough to create full-fledged savings until the state retirement age (the average age of participants is 48 years). People apply for participation in the 3rd level late, when old age is approaching, therefore it is not possible to accumulate sufficient pension capital at 3rd level. Consequently, the average accumulated private pension capital per participant of the pension plan in 2017 was only 1,516 euro. FinanceLatvia recommends that it would be advisable to make regular contributions with a monthly contribution rate of 5-10% of the monthly gross salary (FinanceLatvia, 2018). In addition, contributions made to private pension funds since 2017, in accordance with a collective or individual membership agreement, if they do not exceed 10% of the employee’s gross salary, are not subject to labour taxes.

There are two types of private pension funds in Latvia – closed and open. Employees of the companies or organisations that have established it may become members of the closed pension fund. Trade unions have also set up closed pension funds on the basis of a collective agreement. There is one closed pension fund “First Pension Plan” in Latvia with less than 13,000 beneficiaries.

The second pillar mandatory funded pension scheme has come under criticism for excessive fees. An independent private start-up fund has emerged, offering substantially lower commissions and favourable terms. The commission fee depends on the chosen pension plan, the commission fee also depends on the client’s status in the particular bank or fund manager and the amount of savings. Accordingly, the 2nd level pension profit is affected by the chosen fund manager and the investment plan (whether it is dynamic or conservative). In order to limit high commissions, which reduce the pension capital, at the end of 2017 the legislator made changes in the legislation, stipulating that by 2019 the commission will not exceed 1.1% for annual plans with investments in shares (dynamic plans) and 0.85% for annual plans without investment in company shares (conservative plans), compared to 2% and 1.5% per annum previously. However, the commission for pension savings in the 3rd pension level (private pension funds) is still the highest among European countries. As a result of pension privatisation, social security of pensions is decreasing.

The government has implemented a support mechanism in order to facilitate investment in 3rd pillar pension funds or life insurance funds that require a savings term of at least 10 years. To facilitate

21 - https://www.financelatvia.eu/nozares-dati/produkti-un-pakalpojumi/
investment in these schemes, government has adopted an income tax exemption for investments in the mentioned fund schemes, this is a 20% deductible amount up to 4000 EUR annually. The goal of the mechanism is to facilitate savings in households, especially long-term savings, that will contribute to the 1st and 2nd pension levels. However according to CSP data of 2nd Quarter, 2020 29.3% of households do not have any savings at all and only 29.8% would be able to sustain their lifestyle and expenses for more than 3 months if they used their savings.

As from 2020, the pension capital in the second pillar (state-funded pensions) can be inherited. Respectively, each participant of the funded pension scheme has the right to choose what will happen to the accumulated capital at the 2nd pension level, if he or she does not reach the old age pension: to add the indicated person’s pension to the 2nd level pension, to leave inheritance in accordance with the procedures specified in the Civil Law, to transfer the state pension to the special budget (in order to be able to pay the pension in case of the loss of a breadwinner).

From the legislator’s point of view, this is one of the ways to motivate people to declare income and make social insurance contributions. Until now, if a person died before reaching retirement age, his/her accumulated capital was transferred to the social insurance budget and used to pay pensions to other pensioners on the basis of solidarity. Although the SSIA carried out an information campaign on the possibility to inherit savings at the 2nd pension level, the campaign has not gained wide resonance and it can be assumed that many are not aware of such an option. In 2019, 4,125 people of working age died in the age group 20-59, the largest number of deaths in the age group 50-59 was close to retirement age.

Overall, the initiative is to be welcomed. Most participants of 2nd pension level choose to bequeath the accumulated capital in accordance with the procedures specified in the Civil Law. The second most popular option is to add the accumulated capital to the 2nd pension level capital of another person.

**Pension purchasing power**

Until 2014, Latvia had a minimum subsistence requirement, this was then abandoned since it was announced that the method of calculating the minimum subsistence was out of date and did not reflect the real situation. So far, no alternative to determining the subsistence minimum has been developed and Latvia, the only one of the Baltic States, has not set a subsistence minimum standard – a justified income level with which it is possible to survive in Latvia.

Thus, when it comes to pensioners’ income or pension, the poverty risk threshold is mostly mentioned. The previous subsistence minimum was developed by the USSR Institute of Nutrition in 1991, so it is understandable that at some point the methodology for calculating the subsistence minimum became inappropriate. The second income assessment, which is recognised as the final minimum income threshold, is the recognition of a person as poor.

The level of financial literacy of the Latvian population is low – in the study conducted in 2019 on the population's finances, making savings, budget planning, etc.) it was assessed with 21.7 points out of 99 maximum possible. The same study reveals that 58% of respondents do not know which investment plan member he or she belongs to, 9% find it difficult to say, 73% do not know what the possibilities of using the accumulated capital are when retiring (FKTK, 2019).

The Purchasing Power Parity Index in Latvia in 2018 was 0.71 of the EU-28 average, while net income in 2018 accounted for 33% of the EU-28 average net income (in 2019 the indicator has slightly improved and reached less than 35%, for a single person without children living in the household). Assessing the solvency of pensions according to the purchasing power parity index, in 2019, on average, one pensioner could buy 31.4 kg of butter per month for his/her pension, whereas one employee could buy 71 kg of butter. In terms of pensioners’ purchasing power in relation to other

With the financial support of the European Union
With the financial support of the European Union

foodstuffs, purchasing power has increased over the last decade, with the exception of certain foodstuffs, whose prices have changed rather as a result of global change and demand.

Income inequality among seniors is one of the highest among EU Member States (5.07), but slightly lower among the general population (6.78).

Possible reforms and recommendations

According to the unions, only a significant increase in wages can improve the sustainability of the pension system, because in a low-wage situation where employees have to think about today's existence, there is really no way to think about old age. It should also be noted that the pension replacement rate of 40% is calculated against the average wage in a country where the average wage is the third lowest among EU Member States. Only Bulgaria and Romania are lower. Latvia also has the lowest minimum wage among the Baltic States and the last time the minimum wage was increased was in 2018, from 380 euro to 430 euro.

Given that a large proportion of employees make social insurance contributions from the minimum wage, a faster increase in the minimum wage is a way to encourage higher contributions to the pension capital accumulation. An increase in the minimum wage from 430 euro to 500 euro, 16.3% per month can lead to a pension increase of 13.7% per month (assuming a 20-year-old who receives the minimum wage and does not yet have savings at 1st and 2nd pension levels). The benefit is lower if the worker is 30 years old and has paid contributions from the minimum wage in the previous 10 years (approximately 10% - the author's calculations do not take into account the indexation of pension capital). Low earnings for both employees and the self-employed are one of the main reasons why effective coverage and pension adequacy cannot be ensured.

On the other hand, the main driver of the gender pension gap is the pay gap between women and men during employment, as well as the fact that women have a longer life expectancy than men. Thus, the solution can be found in the period of employment, promoting equal pay for women and men for work of equal importance. The second thing is health care and timely availability of health services, the importance of preventive measures.

At present, the social insurance tax in the general regime is 34.09%, of which 25.09% is paid by the employer and 11.0% by the employee. The last time social insurance contributions were increased, in 2018, was as a result of the tax reform, which also involved the social partners. Consequently, the social insurance tax was increased by 1%, increasing both the employees’ and employers’ contribution by 0.5%. The changes were made to increase the funding available to the health sector, i.e. 1% of the total mandatory contribution rate is directed to the financing of health care services. It was originally envisaged that the payment of taxes would be linked to the availability of health services, thus reducing the extent of the shadow economy. However, with the change in political leadership, the idea was abandoned on the grounds that health services should be available to everyone and that citizens should not be discriminated against on the basis of the taxes they pay. However, with the increase in social security contributions, the problem has not disappeared: there is still a lack of funding for the health sector, resulting in poor access to services, especially among older people who do not have a health insurance policy card.

However, the share of the shadow economy is still high. Thus, we can talk about fairness and equality of contributions and the availability of services between those who pay taxes and those who do not. In order to increase the funding available to the health sector, there is currently a wide-ranging debate on tax redistribution, which is a mathematical redistribution rather than an increase in the tax burden. Trade unions support cuts in labour taxes, while talks continue in relation to an increase in funding for health care.
One of the additional measures is active employment specifically for the elderly. The employment of older people increases the pension savings, which also means a larger pension, since pensions are recalculated each year on the basis of the social insurance contributions made in the previous year. However, low income and low pensions are one of the reasons why retirees choose to work. Consequently, the fact that pensioners earn extra money to be able to make all payments is unethical and offensive in terms of human dignity. If a person has worked all his life and earned a fair pension, the state should ensure that the person is not forced to work. According to the Central Statistical Bureau, 11% of seniors aged 65 and over could not keep their homes warm due to lack of money, while 60.4% could not cover unforeseen expenses.

Tax must be paid to get a pension. However, workers have different perceptions of solidarity and fair payment of taxes. At the same time, the overall tax burden may be too high to pay social security contributions. The self-employed are not insured against unemployment, accidents at work and occupational diseases, yet their tax rate is almost the same as in the general case, the tax rate should be reduced (however lower contributions mean lower insurance and pension). This could encourage social security contributions, including pension capital from higher incomes and not just from the minimum threshold (minimum wage).

The pension system as a system is not closed and the conditions and results of its entry must be seen in relation to the conditions of other systems that can and do affect the well-being of pensioners and future pensioners. Although everyone is responsible for participating in the social security system, there are basic things that the state must provide. One of them is proper health care, which makes it possible to expect old age with quality and dignity. Consequently, adjusting the retirement age to life expectancy is illogical, since healthy life years should be taken as a basis. Trade unions always argue that retirement age cannot be seen separately from access to health care services, life expectancy and quality of life.

The proportion of pensioners at risk of poverty is very high – 53.8%. Single pensioners are most at risk of poverty. In addition, social transfers do not work efficiently enough, as the proportion of pensioners at risk of poverty remains very high at 47.9%, after receiving social transfers.

In some cases, people do not have access to relevant information and even if they do, it does not mean that they can make the calculations themselves (for example, the information on savings in the first and second pension level can be found separately, etc.).

One specific recommendation would be to reduce the minimum length of service that allows to receive minimum pension. Currently, the minimum length of service is 15 years. The idea is also supported by the OECD. Another recommendation relates to the rate of return and the efficiency of governance and operation of state-funded pensions (second pillar). Fiscal sustainability should be seen in the context of access to and spending on health care services. There is also a risk of a decline in the relative value of pensions.

Trade unions are opposed to raising labour taxes, but one solution would be to reduce personal income tax by increasing social security contributions. At the same time, trust in the social security system needs to be strengthened. The impact of digitalisation and robotisation on the labour market must also be taken into account.

Latvia still has a high share of the shadow economy and a large share of employees do not pay social insurance contributions, including future pension savings. This is also evidenced by the share of taxes collected in relation to GDP. The share of taxes to GDP is one of the lowest in the EU (in 2018 – approximately 31.4% of GDP, on average in the EU-28 they were 40.3%). The low share of taxes collected in the economy is the result of the shadow economy, while labour taxes in Latvia are the
highest among the Baltic States and do not promote the exit from the black economy. The high tax burden on labour has also been highlighted by the European Commission, especially for low-paid workers (European Commission, 2019).

Trade unions are of the opinion that faster wage growth would be needed to increase the social contributions to the social budget. Higher social contribution revenues should be a key driver to fiscal sustainability. It also means activating labour market policies in the fight against the shadow economy and informal employment (one example is sectoral collective agreements, which set a minimum wage at sectoral level – the case of Latvia in the construction sector).

Social insurance contributions are not a social tax, but an insurance premium for various types of insurance, each employee pays social insurance contributions of 20% for future pension savings. In addition, everyone must take some responsibility for investing in future prosperity. On the other hand, state and municipal social assistance and social services provide support to those who have had a major break in their working lives or whose contributions have been too low to ensure a decent old age. At the same time, Article 109 of the Constitution stipulates that the state must create such conditions that a person can have a dignified old age, including sufficient support.

Awareness of pension capital savings at 1st and 2nd pension level can be assessed as insufficient; thus, people do not have a complete understanding of the expected pension in the future. In 2019, the state service portal latvija.lv, where everyone can view their pension capital savings in the 1st and 2nd level, was visited by 692 thousand (number of users who have authenticated during the year), while the state funded pension scheme (2nd pension level) personal account statements were requested by 248 thousand, less than 225 thousand requested information on the projected amount of pension (1st level) (VRAA, 2017). In addition, the information on the projected amount of the pension is incomplete, as the calculations do not take into account the years of retirement age from the time the information was requested. However, it is significantly more than in 2018, when the statement of a personal accounts of the state funded pension scheme (2nd pension level) was requested by less than 138 thousand, that year the information on the projected amount of pension was requested by slightly more than 148 thousand. However, it should be noted that the number of service requests is counted instead of the number of unique users, so the number of unique users may be lower. Therefore, the availability of information and the provision of feedback should be promoted so that people understand their future prospects (VRAA, 2018).

OECD experts call for a significant increase in the minimum pension, from 8% of the average wage to the OECD average of 20% (OECD, 2018). This means that the minimum pension should be increased to approximately two and a half times. Given that pensions are indexed in October each year, the index should also be applied to minimum pensions at least in line with changes in the consumer price index over time.

More and more European countries are making changes to their labour laws to include mandatory employer contributions to private pension savings for the benefit of the employee (FinanceLatvia) in addition to the monthly salary. In Latvia, the requirement to create private 3rd level pension savings is incorporated, for example, in the Railway Law, stipulating certain professions of railway specialists in the regulations of the Cabinet of Ministers. This requirement is incorporated in the collective agreement of the railway company Latvijas Dzelzceļš. A collective agreement at company level or a general agreement in the industry is a good tool to negotiate and strengthen the employer's contributions in the 3rd pension level in order to ensure a decent old age for the employee.
Sources:


ETUC, 2019. European challenges for pension adequacy. Background paper by Igor Guardiancich, Feliciano Iudicone, David Natali, Michele Raitano. ETUC SociAll


With the financial support of the European Union