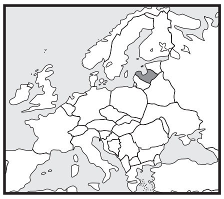
LATVIA

Most old age pensions fall short of basic needs



In the mid-1990s, Latvia became one of the first countries in Central and Eastern Europe to undertake radical pension system reforms, introducing a three-tiered system, raising the retirement age and limiting the possibilities of early retirement, all in the name of ensuring the system's sustainability. A decade later, up to 90% of retired people receive pensions that fall below the minimum subsistence wage level. Thus, instead of a time of well-deserved rest, retirement for the majority is a time of financial constraints and social exclusion.

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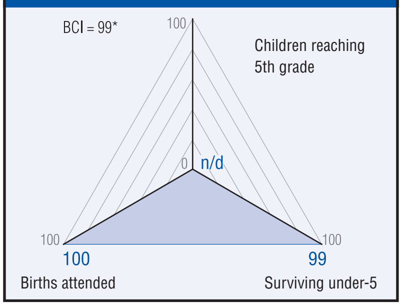
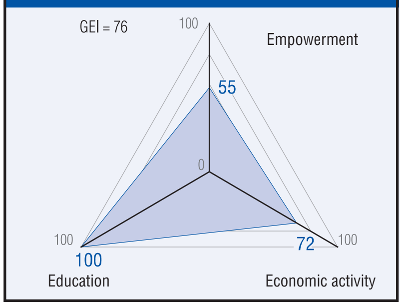
Basic Capabilities Index (BCI)



Gender Equity Index (GEI)



On 18 December 2003, Latvian Minister of Welfare Dagnija Stake, together with Anna Diamantopoulou, member of the European Commission responsible for Employment and Social Affairs, signed the Joint Memorandum on Social Inclusion. The aim of the memorandum was to prepare the country for full participation in the European Union open method of coordination on social inclusion upon joining the bloc in May 2004.[1]

The memorandum was to have strategic significance by guiding the design and implementation of social inclusion policy based on defined priorities. It was a politically declaratory document defining short- and long-term activities to be implemented by the country to reduce social exclusion and poverty, paying particular attention to the people most vulnerable to the risks of social exclusion.

One of the principal political goals stated in the memorandum was to ensure an adequate income distribution. Considering that the social insurance contributions made by workers are rapidly increasing – the average wage has risen from EUR 215 (USD 288) in 2000 to EUR 550 in 2006 – one could presume that pension indexation would reflect this growth in income. Yet this has not been the case, as will be illustrated later in this report.

Pension reform and the adoption of a three-tier system

Latvia was one of the first countries in Central and Eastern Europe to introduce a multi-tiered pension system. Pension reform was set into motion in 1995, when Parliament approved the general reform guidelines developed in 1994. The Law on State Pensions, which enabled the implementation of the first pension tier, went into effect in January 1996; the Law on Private Pension Funds, which corresponds to the third tier, entered into force in July 1998; and the Law on State-Funded Pensions, which regulates the second tier, went into force on 1 July 2001.

The first tier in this new pension paradigm is a state compulsory non-funded social insurance pension scheme, based on the principle of intergenerational solidarity. It is essentially a traditional 'pay as you go' (PAYG) system in which those who are working pay for current pensioners' benefits.

The second tier is a state compulsory funded pension scheme, based on individual contributions to privately managed savings accounts financed from payroll taxes. Second-tier contributions are mandatory for employees who were under 30 in July 2001, when the scheme came into effect, and optional for those aged 30 to 49 at the time. Contributions will rise gradually from 2% of income between 2001 and 2006 up to 10% from 2010 onward, and contributions to the first pillar will be reduced proportionally (from 18% in 2001 to a matching 10% as of 2010).[2]

This mandatory fully funded scheme was originally administrated by the Latvian Treasury only, which was allowed to invest the contributions solely in government securities and term deposits with banks. Since 2003, however, workers have had the option to choose from a group of private providers who are authorized to offer a wider range of investment options and more diversified portfolios.[3]

The third tier is a system of voluntary private pension funds. Upon retirement, individuals who have invested in private pension funds can either receive a lump sum payment or life annuity from the private fund provider, or transfer the capital accumulated to the first pension tier in order to receive a pension based on the first-tier calculation formula.[4]

Other reforms adopted to ensure the future sustainability of the pension system included raising the age of retirement and reducing the possibility of early retirement. The transition to the new retirement age of 62 is being carried out on a step-by-step basis, with a six-month increment each year. The retirement age for men reached 62 in 2003, while the retirement age for women will reach 62 in 2008.

Workers who have made social insurance contributions for at least 30 years will still be able to opt for early retirement up until mid-2008, but from that point on, this possibility will be eliminated. For now, early retirement can be taken up to two years before the official retirement age.

Another form of early retirement that was a feature of the fully state-financed pension system before the reform was undertaken was that of 'long-service pensions', also referred to as service pensions. The former system allowed workers to retire with a pension before the regular retirement age in occupations that involved health-threatening working conditions – high stress, exposure to dangerous substances, noise, etc. – or when the ability to work in the occupation depended on age, as in the case of performing artists like musicians and dancers. Service pensions were also granted in the case of occupations or work positions considered to have special merit.

When the new three-tier pension system came into effect in 1996, it limited the availability of long-service pensions to a small number of public sector

* One of the BCI components was imputed based on data from countries of a similar level.

1 <ec.europa.eu/employment_social/social_inclusion/docs/lv_jim_en.pdf>

2 <worldbank.org/html/prddr/trans/marapr02/pgs34-35.htm>

3 <www.fiap.cl/p4_fiap_eng/antialone.html?page=http://www.fiap.cl/p4_fiap_eng/site/artic/20060529/pags/20060529155034.html>

4 *Ibid.*

posts, such as civil servants at the Ministry of Internal Affairs and the Constitutional Protection Bureau and public prosecutors. This move was highly criticized, especially since it eliminated the possibility of early retirement in occupations where continued activity genuinely depends on the workers' age and state of health. Performing artists, for example, are often not able to continue working in their professions until the age of 62, yet there are few other jobs they can turn to as an alternative.[5]

Pensions within the social insurance system

Funding for the social insurance system as a whole is based on the social insurance budget, which is divided into four 'special budgets': occupational accident special budget 1%; employment special budget 8%; disability, maternity and sickness special budget 16%; state pension special budget 75%. There are two basic principles underlying the current national social insurance system. The first is that social insurance service corresponds to the social contributions made, and the second is solidarity between those who pay social insurance contributions and the recipients of social insurance services.

According to the commitments made by the government, adequate state support should be available to everyone who needs it. Given that 75% of the total social insurance budget corresponds to the state pension special budget, and the vast majority (80.8%) of pension recipients are old age pensioners, it would be quite telling to take a closer look at the reality of retired people's lives in Latvia.

Pensioners living under minimum subsistence level

Two years after signing the Joint Memorandum on Social Inclusion, Minister of Welfare Dagnija Stake acknowledged in an interview with *Latvijas Avize* on 27 October 2005 that in order to provide a subsistence wage level pension for all the retired people in Latvia, the country would need an extra EUR 7 billion. In the same interview, she was forced to admit that 94% of pensioners were living under the minimum subsistence wage level at the time.

Latvia has no official poverty line or basic poverty line that could apply to its population and be accepted as the sort of critical minimum applied in other European countries. Under normal circumstances, the underprivileged can be seen as those whose monthly income per household is below the basic minimum wage. In 2006, the official minimum wage was EUR 130 or 76% of the minimum subsistence wage. This hardship is endured by 19% of the population.

On November 2005, the Cabinet of Ministers defined a new state-guaranteed minimum income (GMI) level, which was to be increased from EUR 30.17 in 2005 to EUR 34.48 in 2006. The amendments adopted provided for an increase in the income level for families or persons living alone and whose income does not exceed EUR 34.48 per person a month. According to statistical data, around 150,000 people or 6.5% of the total population fall in this group. There is no data provided on the age groups of those being forced to beg for help from the state to receive the miserable sum of just over EUR 34 per month.

TABLE 1. Minimum cost of living and income indicators (in EUR)

Year	2000	2001	2002	2003	2004	2005	%
Average value of minimum consumer basket of goods and services	159.57	158.88	148.73	145.11	146.17	**157.57**	100
Minimum wage						**118.76**	75.37
Average pension* in EUR	109.04	104.60	103.91	98.52	103.37	**115.70**	73.43
Minimum pension						**71.12**	45.14
State guaranteed minimum income						**34.48**	21.88

* The decrease in pension amounts in EUR is the result of rises in the exchange rate for the national currency, the lat. Expressed in national currency, the average pension has gradually increased from LVL 84.16 in 2000 to LVL 106.14 in 2005.

On 17 June 2006, the national news agency LETA reported that according to data from the State Social Insurance Agency (VSAA), 405,900 old age pensioners, or 86% of the total, receive pensions that are below the minimum subsistence wage. In other words, of the 471,200 people provided with old age pensions by the VSAA, only 14% receive a pension that exceeds the minimum subsistence level of the population as defined by the Central Statistical Bureau of Latvia. In fact, the lowest pension paid in 2006 was only 43.14% of the minimum subsistence wage.

The percentage of consumption expenditure allocated to food is recognized as an internationally comparable material welfare indicator. The provisional data from a household survey on consumption expenditures in 2006, compiled by the Central Statistical Bureau, reveals that in households of employers and the self-employed, as well as households of wage and salary earners, expenditure on food constituted 26% of consumption expenditure. Households of pensioners, however, devoted 43% of their total consumption expenditure to food.[6]

The Central Statistical Bureau also conducted a household survey in 2005 in which respondents were asked to self-appraise the financial and material situation of their own households. According to the survey results, slightly more than one fourth of households (26%) expressed the opinion that they are on the threshold of poverty, while another 5.6% of households consider themselves to be poor. In view of the income and cost of living figures presented in Table 1, these results come as no surprise. The situation is particularly difficult for pensioners: while the monthly cost of a minimum consumer basket of goods and services is estimated at EUR 157.57, the average pension is only EUR 115.70, while there are some who receive pensions as low as EUR 71.12.

Is it possible to survive?

On 17 April 2007 one of Latvia's leading daily newspapers, *Neatkariga Rita Avize Latvijai*, published an article entitled "Pensioners survive by working together". The article was an interview with Zenta Denisova, a retired history teacher who runs a Retired Teachers' Club.

"Complaining achieves nothing," said Denisova. "One may claim that you can't survive on one lat (EUR 0.7) per day, but we can. Only it is not a pleasant form of retirement, it is rather merely an existence. For many of its members, this club is the only hope in these booming millionaire times not to fall in a depression, and to be among peers. If the poor countries of the world have to survive on a dollar per day, pensioners in Latvia in comparison to most African countries don't even get that, due to the extra cost of winter heating."

During a meeting with Minister of Social Integration Oskars Kastens on 29 May 2007, representatives of the Latvian Pensioners Federation (LPF) pointed out that the elderly have been marginalized from general society. LPF leader Aina Verze noted that "pensioners are a central part of society who have given their working lives for the benefit of the state, and of course they are belligerent at the injustice forced upon them."

"Approximately 36,000 pensioners live below the poverty line and consequently have no possibility for a fulfilling life," she stressed, noting that the exclusion faced by the elderly impacts on almost every facet of life, from taking part in cultural events to maintaining their state of health.

Clearly, the government has a long way to go in making the promise of social inclusion a reality for the country's senior citizens. ■

5 <www.eurofound.europa.eu/eiro/2004/03/inbrief/lv0403101n.html>

6 <www.csb.gov.lv/csp/content/?cat=471&id=2921>