



# **LATVIAN NATIONAL REPORT ON ADEQUATE AND SUSTAINABLE PENSIONS**



**July 2005**

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## INTRODUCTION

The Lisbon European Council of March 2000 adopted a strategic goal of European Union (hereafter – EU) development – “to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion” by 2010 (“the Lisbon strategy”). To achieve this goal one of the key objectives is to ensure the long-term financial stability of state public sector’s funds and the modernisation of the social protection system.

Significant reforms in the area of social policy have already been accomplished in Latvia – as a result of the social security reform a modern and sustainable social security system has been created. It is based both on contributory and non-contributory benefits and protects people against all traditional social risks. The pension reform in Latvia has been completed – three-pillar pension system has been established. Currently, Latvian national pension policy is progressive, modern and financially stable in the long-term.

Social policy in Latvia, like in other EU member states, is inseparably linked to economic development. Economic growth and employment form prerequisites for a highly developed social protection system. Opportunities to work and receive sufficient remuneration are essential not only for promotion of welfare of workers and their families, but also for improving living standards of older people. Certainly, the living standards in Latvia are increasingly affected by the consequences of population ageing. Demographic statistics show that currently the number of persons over working age corresponds to 21,8 per cent of the total population in Latvia and these numbers are expected to increase during the next years, whereas the number of people in working age will decrease.

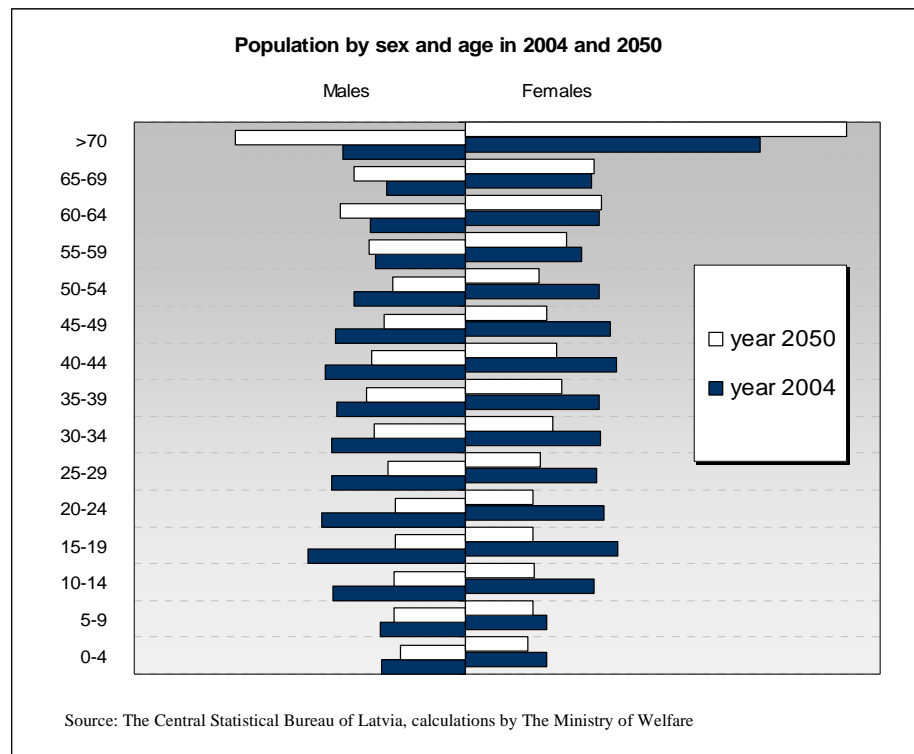
Latvia, like other new EU member states, has prepared its first National report on adequate and sustainable pensions in 2005. The report was based on eleven common objectives, defined by the Laeken European Council of December 2001, covering reduction of social exclusion risks, promotion of employment, access to resources, facilitation of solidarity and gender equality as well as formation of the pension system in accordance with the needs of society. Implementation of these objectives will help to evaluate (by using the EU’s and national sets of indicators) Latvia’s progress towards achievement of the common European goals and to exchange good practice examples with other EU member states in the field of pension policy formulation, thereby facilitating the impact of the Open Method of Coordination. The Latvian National report was prepared in close cooperation with experts from relevant ministries and institutions, actuaries of the private pension funds and social partners. The Single Strategy of National Economy, Single Programming Document (for 2004-2006), National Employment Plan for 2004 and National Action Plan for Reduction of Poverty and Social Exclusion (for 2004-2006) were taken into account.

## 1. GENERAL REVIEW

The problem of population ageing and its impact on the long-term sustainability of adequate and financially stable pension systems has been emphasized in most European Union Councils. Eleven common objectives proposed by the Laeken European Council in December 2001 address three main goals: ensuring the functioning of the system in connection with achievement of main social targets, retaining financial stability of the system and satisfying the needs of society.

### 1.1. Demographic situation

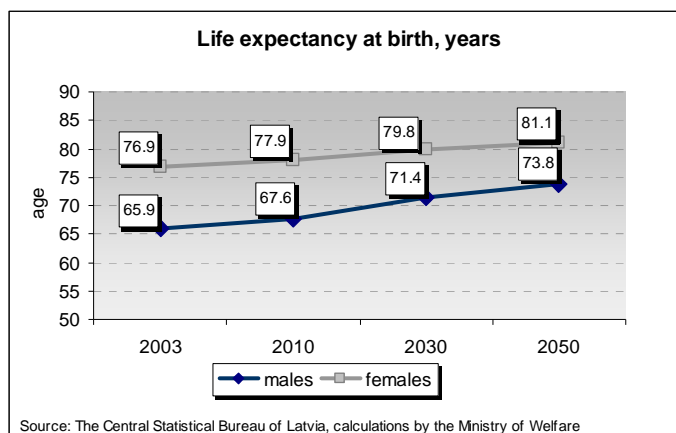
Rapid ageing of the population is observed in Latvia and it is characterised by a low birth rate and an increase in average life expectancy. It can be inferred from demographic forecasts that in general the number of the employed persons will remain stable until 2010, and it could decrease sharply between 2010 and 2030. The decline will be accompanied by substantial changes in the age structure of the labour force due to a rapid decrease in the number of young people (aged 15-24) and a simultaneous increase in the number of people of the 45-64 age group, which will generate a significant number of old people in the period up to 2050.



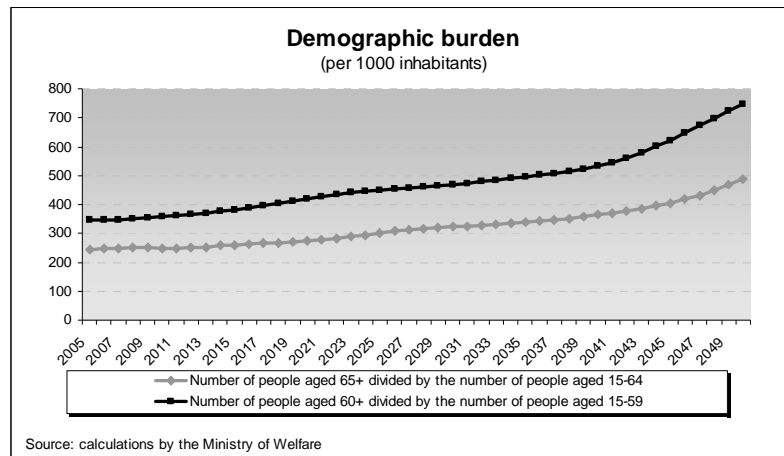
The demographic situation in Latvia is negative already for several consecutive years. The natural growth of population has remained negative since 1991. While a slight increase in the birth rate was observed in 2004, it cannot be viewed as a stable indicator of positive development considering the fluctuations in the birth rate since 1995. Although the total

fertility rate is gradually increasing (from 1,237 in 2000 to 1,240 in 2004), this falls short of the levels required for generation change and is one of the lowest in Europe.

Improvements in living conditions and in the general health state of the population raise in the life expectancy at birth and for people over working age. The forecasted life expectancy at birth in 2003 is 71,4 years (for males – 65,9 years and for females – 76,9 years). As in other European countries, the life expectancy at birth for females in Latvia is higher than for males. The considerable difference between these two figures is determined by the higher male mortality, especially due to external death factors and tumours. However, when the critical periods of life are over prospective life expectancy for males, who reached the age of 60 in 2003, is 15,13 years and for females – 21,48 years. Demographic forecasts testify that the prospective life expectancy will continue to increase and it will gradually promote the ageing of population even more.

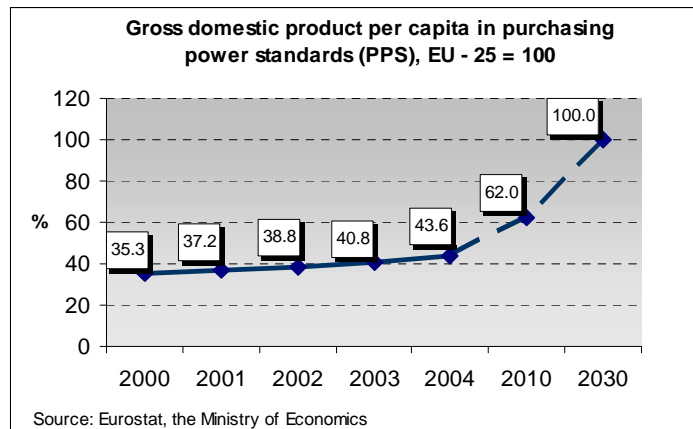


In 2004 the share of population aged 60 was 22,1% and over 65 years – 16,2%. Notwithstanding the considerable financial burden of tax-payers, the current demographic situation compared with the future perspective in the context of state pension system on the whole should be seen as favourable, because today pensions are drawn by a quantitatively small generations born during the Second World War. Meanwhile, the generation of people born in 1980s (when the birth rate was twice as high as the current one) form an in-flow to the working age group. However, this will change in the very near future when the quantitatively small group of people born in 1990s, when the birth rate decreased, will reach working age. At the same time, people born during the years when the birth rate was relatively high will reach retirement age. If currently there are 236 people aged 65 years and above on each 1000 inhabitants in the working age in Latvia, then, as it is forecasted, in 2050 this demographic burden will reach 486, i.e. every two social insurance contribution payers will have to provide a pension for one pensioner.



## 1.2. Socio-economic situation

One of the EU's highest economic growth rates is observed in Latvia. Between the years 2000 and 2004 the real increase of Gross Domestic Product (GDP) per year was 7%. The GDP per capita has increased as well (in purchasing power standards). However in 2004 it was only 43,6% of the EU average level, which is expected to be reached by 2030.



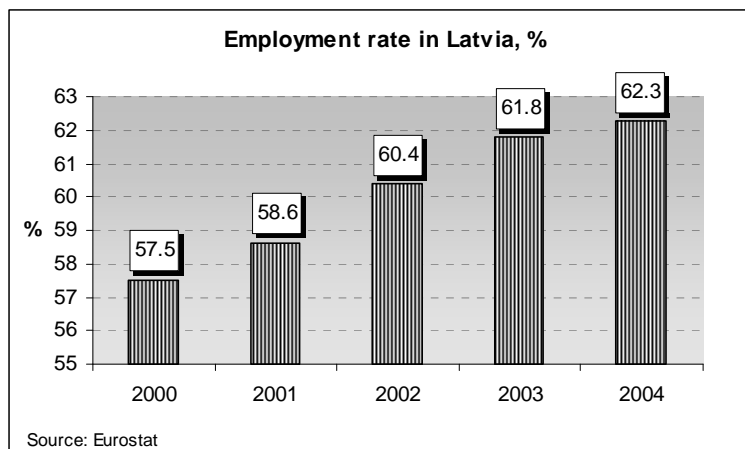
In 2000–2003 the average inflation rate has been between 2-3%, which is one of the lowest among the EU member states. Whereas, in 2004 inflation reached 6,2% affected by the increase in the euro exchange rate, the increase in administratively regulated prices and the increase in the oil prices.

The gross rate of investments and their proportion in GDP (in 2004 – 4,5%) in Latvia is one of the highest in the EU, which is caused by various factors: stable macroeconomic environment, low interest rates, consolidation of the banking sector etc.

Through implementation of a strong fiscal policy, the fiscal deficit of the state consolidated budget in Latvia in the period since 2000 has been lower than allowed by the Maastricht criteria (3% of GDP).

Latvia's state debt is small compared with the average debt in the EU and considerably lower than the level defined by the Maastricht criteria (60% of GDP). In 2004 it was 14,4% of GDP (EU 25 – 63,8%).

The economic growth in Latvia, observed during recent years, has positively affected the situation in the labour market. The employment rate (since 2000) has increased by 4,8 percentage points and in 2004 it was 62,3% (EU – 63% in 2003).



The unemployment rate in Latvia continues to decrease gradually and in 2004 it was 9,8% (for males – 9,2%, for females – 10,3%), which is slightly higher than the average indicator in the EU (9,0%).

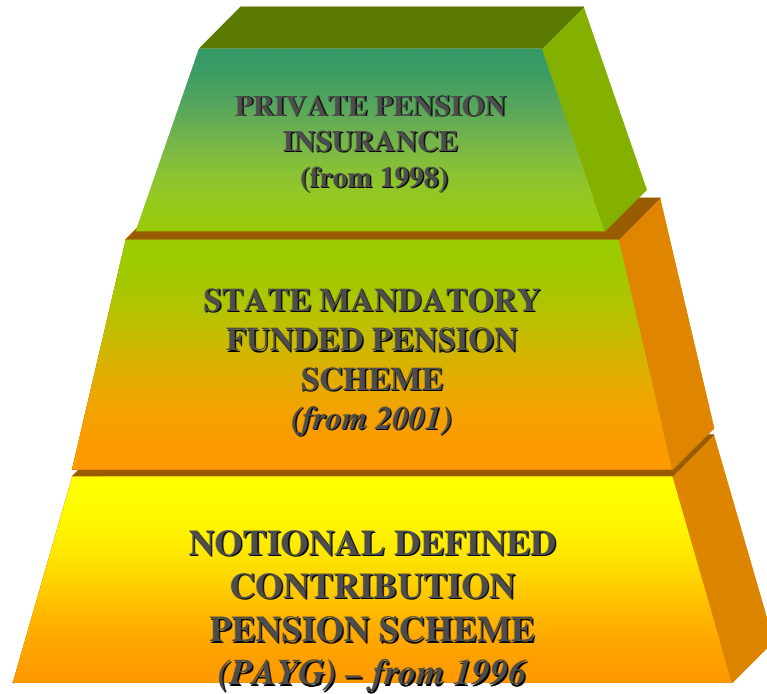
As a result of the economic development wages have also increased in Latvia, but not on adequate level. The average wage of the employed in the national economy in 2004 was 211 LVL, which has increased since 2000 by 41,1% (GDP by 57%). Average wage for females, as well as in other EU member states, is still lower than for males – in 2004 by 15%. There are also income inequalities between the urban and rural population.

On 1 January 2004 the minimum wage in Latvia was 80 LVL per month (the lowest among the EU member states) or 37,9% of the average wage of the employed in the national economy, which is below the minimum level defined in the European Social Charter (68% of the national average wage). The relatively considerable proportion of employed persons (14-20%) has not officially declared their real income from work and their social contributions and income tax payments have been made from the minimum wage only. In 2003 19,7% of employees received the minimum wage or less than minimum wage.

### 1.3. State pension system

The ageing of the population was considered as a major problem when the pension reform was initiated in 1995. As a result of the reform a new pension system was created in Latvia, which is able to perceive the demographic fluctuations with maximum flexibility and to provide long-term stability under the circumstances of progressive ageing of the population.

The pension system in Latvia consists of 3 tiers (according to the World Bank's terminology) and it diversifies risks typical both for the schemes of inter-generational solidarity and for pensions schemes saving real capital. Income redistribution elements are also present – between poor and rich people, as well as between generations.





## 2. ADEQUACY OF PENSIONS

The state social security system as well as social assistance and social services systems guarantee a partial replacement for labour income in cases of becoming economically inactive (falling ill, losing job, reaching certain age), thus providing support for the maintenance of the quality of life during certain periods.

The Latvian pension system is directly linked to the state economic situation. Due to significant proportion of “grey-sector” economy and the high level of unemployment, pension amounts are frequently inadequate as they depend on social insurance contributions. In such cases the state has defined the minimum income threshold for pensions as well as the guaranteed minimum income for social assistance purposes.

In conformity with the Latvian National Action Plan for Reduction of Poverty and Social Exclusion (for 2004 – 2006) old people are identified as one of the groups at risk of social exclusion.

Currently, the main priority of pension policy is to improve the living standards of pensioners, by providing adequate pension amounts and reaching a replacement rate of 40-60% of previous income.

### 2.1. Objective 1: preventing social exclusion

**Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate actively in public, social and cultural life.**

Government policy in the field of increasing social inclusion and tackling social exclusion is reflected in the Joint Memorandum on Social Inclusion, where the main political goals, priorities, medium-term and long-term tasks in this field are defined. Latvia has elaborated the National Action Plan for Reduction of Poverty and Social Exclusion in order to ensure social inclusion. The creation and implementation of the plan can be viewed in the context of EU’s social inclusion process, which has a goal to decrease poverty in Europe till 2010.

Risk-of-poverty threshold in Latvia is relatively low. In 2002 17% of inhabitants in the age group under 64 were subject to the risk of poverty (males – 18%, females – 17%). Comparatively, the risk of poverty for total group of inhabitants in the age over 65 is lower (10%) than for inhabitants in the retirement age, whose main income originates exclusively from pensions, and for inhabitants over 75 years (13%). The risk of poverty is explicitly higher for women (average 14%) than for men (average 7%) within the above-mentioned age groups. Social transfers, including pensions, play a very significant role in decreasing poverty. In 2001 14,3% of GDP was devoted for the social protection expenditure, which is

one of the lowest indicators in the EU (27,3%). More than half (8,6% of GDP) of all social protection expenditure is spent for provision of pensions.

In 2004 the replacement rate of newly granted old-age pensions was 68,6%, however, the average amount of pensions is low taking into consideration low labour income from which social insurance contributions are being made. As verified by data from the Household Budget Survey, main income of pensioners' households is formed by social transfers (87,4% of disposable income), including pensions (79,9% accordingly). Although, income of pensioners' households is gradually increasing, it is lower than the average households' income level (74,7% of the average level). As a result pensioners face higher poverty risk. Income is mostly spent on food, housing costs and payments for medical care, while only slight sums are spent on clothes, footwear, leisure and culture. The possibilities to integrate in the life of society for this at risk-of-exclusion group (due to low income) are limited.

Due to the denationalisation of housing and privatisation of municipality-owned dwelling houses, 68% of all inhabitants in the age over 65 have lodging in their private possession, but 32% live in the apartments owned by other persons. The main problem connected with housing is low income level and comparatively high rental and public utility charges. In 2003 pensioners' households spent 19,1% of their income for costs of such commodities. More favourable is the situation of households of elderly people consisting of more adult family members and thus generating higher income (in 2000 76,6% of inhabitants in the age group over 65 lived together with some other adult person). For the pensioners, who live in the housing owned by other persons, the risk of poverty is remarkably higher than for those who own their housing.

One of the groups facing insecurity in the current Latvian housing market are persons, who have reached retirement age, live in large cities and are not able to pay rental costs or to find apartments on their own corresponding to their financial resources. People who rent apartments in the denationalised houses are facing the risk of being evicted from their apartments because of the debt for rental and public utility payments or due to capital renovations at the same time being unable to obtain housing in the free housing market. Meanwhile, the building of the municipal apartments has noticeably decreased in the last decade. There is also lack of social housing and apartments in Latvia – in 2004 there were 1229 social apartments and 82 social houses (36% from the residents are pensioners).

In case of income inadequacy, inhabitants are entitled to claim for social assistance from their municipality. In 2004 the following social assistance allowances provided by municipalities were defined by legislation: a guaranteed minimum income benefit (GMI benefit), apartment allowance and lump-sum allowance in a case of emergency. Moreover, municipalities have the authority to pay other benefits after well-grounded claims for the guaranteed minimum income benefits of the residents in the municipality have been satisfied. GMI benefit and apartment allowance (both in cash and in kind) are means-tested and granted basing on the assessment of financial and other resources of the claimant's household. In this case pensions as well as state benefits are considered as the person's

income. Pension recipients are the main target group for the provision of municipal apartment allowances and allowances to compensate for medical care costs. In 2004 various municipal allowances were received by 114,8 thousands or 23,8% of old-age pensioners.

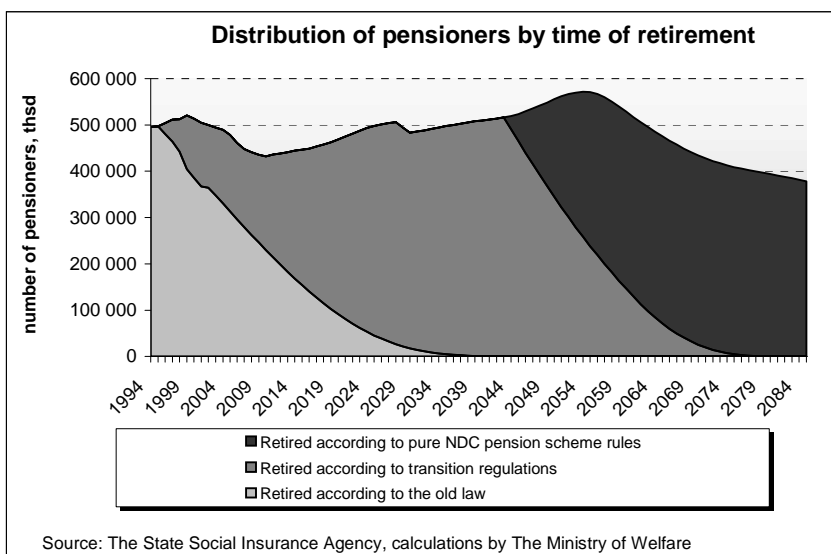
Social care services close to the place of residence (home care, day-centres), which could form alternative to the long-term social care institutions and could make it possible to stay at home for those not able to care for themselves are not sufficiently available for old people. Therefore, there is relatively large amount of old people and disabled people in Latvia, who reside in the long-term social care institutions and whose number tends to increase under the circumstances of population ageing. In 2004 1,1% of all inhabitants in the age group over 60 (40% - males and 60% - females) and 1,8% of all inhabitants over the age of 70 (74,5% - females and 26,5% - males) were residing in the social care institutions.

## 2.2. Objective 2: enabling people to maintain living standards

**Provide access for all individuals to appropriate pension arrangements, public and/or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement.**

State social insurance system, whose main component are pensions (81,5%), is based on the principle of solidarity and correspondence between the amount of social insurance benefit received and social insurance contributions made, providing a certain income replacement level for pensioners. For persons aged over 65 the relative average income in 2002 was 82% (for males – 87% and for females – 80%) compared to average disposable income of persons younger than 64 years.

Notional defined contribution pension scheme (NDC PAYG) has been operating since 1<sup>st</sup> January 1996. It covers both pensioners, whose pension was granted before 1996 (63,6%) and pensioners, whose pension according to the new legislation, is calculated by the new pension formula (36,4%) basing on social insurance contributions, which have been made since January 1996 registered in a personalized account. A long transitional period has been defined in Latvia that will end when the generation which began to accumulate its pension capital under the new regulations (since 1<sup>st</sup> January 1996) will retire. Insurance record in the transition period (before 1<sup>st</sup> January 1996) is being formed by initial pension capital, it's amount being dependent on the social insurance contribution wage during 1996-1999.



Socially insured persons (employees, self-employed etc.) making social insurance contributions provide pensions for current pensioners, while simultaneously accumulating pension capital for their own pensions. In order to ensure uninterrupted pension insurance record during the periods, when a person is economically inactive – being unemployed, disabled, on parental leave, serving in obligatory military service or in the event of the incapacity for work - social insurance contributions are made from the state budget. The number of socially insured persons is growing on yearly basis and in 2004 their proportion of the economically active population was 98,5% (males – 47% and females – 51,5%). According to the forecasts the trend will remain unchanged during the next 40 years.

The state pension system (based on social insurance contributions) guarantees old age pensions, survivor's pensions, disability pensions as well as service pensions (in transitional period) for representatives of certain professions.

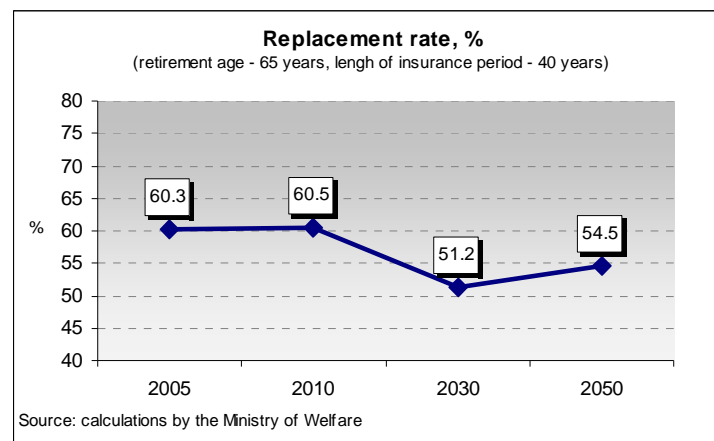
State mandatory funded pension scheme is operating since 1<sup>st</sup> of July 2001. The main objective of the state mandatory funded pension scheme is to achieve the increase in pensions' amounts without increasing the total social insurance contribution rate for state old-age pensions (20% of wage) by investing a part of the contributions in the financial capital market, where the funds will create interest profits.

State mandatory funded pension scheme covers persons, who in accordance with the legislation are compulsory (persons who during the scheme's first year of operation were under 30 years of age) and voluntarily (persons who during the scheme's first year of operation were aged between 30 and 49 years) participating in this scheme. People over the age of 50 were not included in this scheme. The number of participants in this scheme from the start of it's operation has increased for 2,3 times and in 2004 it was 633,7 thousands or 43,5% of all inhabitants in the working age (46% - males and 54% - females). Average age of participants was 31,5 years. According to the forecasts the number of participants will increase until 2050 to 87% of all inhabitants in the working age.

The contribution rate for this scheme is 2% of wage, but it will gradually increase and reach 10% by 2010. If a person is participating in the both levels of pension scheme, the total contribution rate for state pensions (20% of wage) will be shared equally between the two levels. Accordingly, if 2% of wage are being paid to the state mandatory funded pension scheme, the remaining 18% are paid to the inter-generational solidarity scheme, but in 2010 contribution rates in both levels will be equalized – 10% for each.

There are two opportunities for earning funded pension. First, pension capital is transferred to the life insurance society chosen by the person, which ensures life annuity pension. Second, pension capital is added to the capital accumulated in the NDC PAYG scheme.

Therefore, by participating both in the first and the second level of pension system, there is a greater opportunity to accumulate higher pension capital and thus ensure higher income replacement level during the old age. Forecasts testify that for persons with insurance record of 47 years, retiring in the age of 62 in 2010, income replacement rate will be 62,9%, meanwhile during shorter participation in the system income replacement rate will also be lower, for instance, for persons with insurance record of 40 years – 53,0% and 25 years – 31,6%. Due to increase in the average life expectancy pension disbursement time will also increase, but income replacement rate in further years will decrease.



Voluntary private pension scheme is operating since 1<sup>st</sup> of July 1998 and the purpose of this scheme is to accumulate and invest the voluntarily made contributions of its participants by means of private pension funds thus ensuring additional pension capital in old age. Pension funds may be closed or open and they may have one or more pension plans. Pension plan participants may participate directly or with involvement of their employer. The pension plan participant can receive all accumulated pension capital from the age of 55 or continue participating and receive capital in parts. Accumulated capital is the private property of the person irrespective of the fact by whom the contributions were made and further inheritance rights are applied to it. Reduced income tax payments and social insurance contributions are applied as well.

The number of private pension plan participants is gradually increasing and in the end of 2004 there were 39,0 thousands of participants or 2,7% of total working age population (50% - males and 50% - females). The average age of participants was 41 years. 3% of pension plan participants had already reached the pension age and were receiving additional pension capital. As forecasts show, the number of participants will increase until 2050 to 15% of all inhabitants in the working age.

Participation in private pension plans is a long-term investment. As private pension funds have begun to operate relatively recently, participants of pension plans have not yet had time to accumulate such additional pension capital, which would constitute the important part in income replacement. However, by continuing payments to pension plans during the longer time period it is expected that this part will become more considerable.

### **2.3. Objective 3: Promoting solidarity**

#### **Promote solidarity within and between generations.**

There is relatively high level of income inequalities in Latvia. The Gini coefficient characterizing the inequality in income distribution in 2003 was 36% and this is one of the highest in comparison to the other EU new member states. The income distribution (income quintile share ratio) between the higher and lower quintiles S80/S20 in Latvia was 6,1 in 2003.

Current NDC PAYG pension scheme in Latvia is based on the solidarity principle between generations as well as within each generation.

Contributions of socially insured persons to the NDC PAYG pension scheme are being directed to the current pension payments – in 2004 1088,7 thousands of socially insured persons ensured pensions for 590 thousands of pensioners. Social insurance contributions for pension insurance are being registered in the personalized accounts and adjusted by social insurance contributions wage indexes. So, it is possible to say, that notional pension capital is earning interest, like it happens when investing financial resources, however, in NDC PAYG pension scheme the capital “profit” is being defined by increase in wage amount and increase in the number of contributions payers, whereas the increase in capital within funded pension schemes is being defined by financial capital market fluctuations. If in the second year of reform the index of contributions wage was 1,03, then, due to the increase in the number of socially insured people and amount of wage, in 2004 the respective index was 1,1754.

The amount of registered social insurance contributions for pensions is increasing yearly (in connection with contributions made and due to indexation), therefore by the retirement so called notional pension capital or information on social insurance contributions made during the working life is accumulated. This capital, which is equal to thousands of LVL, by the

claiming for the state old age pension is being spread equally over the disbursement years for the rest of projected life, i.e., the pension capital is being divided by the life expectancy, which is predicted for the pension claimant.

In order to compensate decrease in pensioners' purchasing power due to inflation and to ensure real increase in pensions, pensions (depending on their amount) are being indexed (adjusted) in accordance with consumer price index and share of real growth of contribution wage. Taking into consideration the capacity of social insurance budget (in the period of 1999-2002 there was a deficit and a loan was taken to finance it), currently pensions lower than 175 LVL are being indexed twice a year. Since 1996 the amount of old age pension has increased by 31,15 LVL.

As the growth of wages does not correspond to the national economy growth and, taking into consideration the large share of "grey-sector" economy, the payment of contributions from small wages results in low pensions. In such cases the state guarantees a defined minimum or minimum pension, whose amount is equal to the amount of state social security benefit (in 2004 – 35 LVL), to whom depending on the length of insurance record coefficients are applied: for insurance record under 20 years – 1,1; 20-30 years – 1,3 and over 30 years – 1,5. In 2000 guaranteed or minimum pension recipients were 61,6% of all persons to whom pensions were granted, which has decreased to 37,3% in 2004.

Such people, whose insurance record is not shorter than 30 years, but whose income has been below state average income level are also supported financially, e.g. for starting capital calculation in relevant years (1996–1999) the average wage in the state is taken into account and not the individual insurance contributions wage.

If the person has insufficient qualification period (or no such period at all) to be eligible for the state old age pension (minimum qualification period is 10 years of insurance), but has reached corresponding age (5 years above statutory retirement age), the state social security benefit is being guaranteed (in 2004 – 1,4 thousands of recipients).

For protection of current as well as future pensioners in the cases, when employer hasn't fulfilled his responsibilities and hasn't made social insurance contributions, the state has undertaken to include these periods in the person's total insurance record. Certainly, the employer (who's actually operating) isn't released from his liability to the state – to pay all social insurance contributions.

#### **2.4. Strategy to achieve the goals**

Latvian pension system is based on the principle of solidarity (**3<sup>rd</sup> goal**) and it gradually tends to reduce social exclusion (**1<sup>st</sup> goal**) and to provide adequate pensions (**2<sup>nd</sup> goal**). The precondition for achieving the last two goals is stable and sustainable economic development. For implementation purposes Latvian government has approved the Single Strategy of National Economy for 2004 – 2006, defining the following main directions:

provision of macroeconomic stability, formation of conditions favourable for functioning of economy and entrepreneurship, stimulation of establishment of effective and competitive sectoral structure, reduction of socio-economic disparities and ensuring sustainable development.

In order to provide adequate social security coverage for every Latvian pensioner during the old age, it is necessary to continue the implementation of the following activities: increasing the minimum wage, provision of additional social security for low pensions recipients, regular adjustment of GMI levels.

As there is a relatively large number of pensioners in Latvia who receive low pensions, one of the priorities is to maintain the living standards for pensioners after retiring: within the possibilities of insurance fund it is envisaged to increase pensions for the pensioners with long insurance records, by defining monthly additional payment for people in the retirement age, whose total insurance record is not shorter than 30 years and whose pensions are not higher than 105 LVL. Additional payment is prescribed for each social insurance record year accumulated before 1<sup>st</sup> January 1996 (before the reform). As a result on average pension would increase by 6,63 LVL. This could be seen as a partial 4<sup>th</sup> level of the pension system (state guaranteed minimum pension during transition period, additional to the pension earned individually).

Special attention needs to be paid to the availability of adequate housing for people, who are not able to purchase apartments in the housing market or whose income doesn't allow to pay full costs for housing used by the family and for public utility services.

In order to ensure a complete inclusion of old age people in the life of society, it is important to ensure that they are able to receive social rehabilitation and social care services they need, as close as possible to their place of residence and without delay by developing network of social services in the municipalities, by providing the increase in the number of professionally-educated social work specialists offering social services and working in social services institutions and by widening the scope of social care and social rehabilitation services, simultaneously improving the necessary infrastructure.



### 3. FINANCIAL SUSTAINABILITY OF PENSION SYSTEMS

Latvian pension system is financially stable in the long-term perspective: it is flexible in relation both to the retirement age and pension accumulation types and also to pension payment during the disbursement phase. It is a significant support to the sustainability of national economy and also to achievement of the goals of employment policy – integration of all capable of work into the labour market, extending the active working life as far as possible, decreasing the incentives for early retirement by making the participation in the labour market a more attractive option and simultaneously providing incentives for the employers to employ older people.

#### 3.1. Objective 4: raise employment level

**Achieve a high level of employment through, where necessary, comprehensive labour market reforms, as provided by the European Employment Strategy and in a way consistent with the BEPG.**

The main goal of Latvian employment policy is to raise the employment rate, reaching the EU's defined strategic targets in future, as well as to tackle the problems of unemployment, basing these efforts on successful economic growth. Nowadays rapid development defines new and higher requirements for retaining the ability to compete in the labour market.

Since 2000 annual National Employment Plans have been developed in Latvia, whose goals are in line with the European Employment Strategy and guidelines. Employment supporting activities defined in the National Employment Plan for 2004 are closely linked to Latvian and European Commission's Joint Declaration on Latvian employment policy's priorities, the Single Programming Document (for 2004-2006), and the New Employment Guidelines for 2003-2005 accepted by the EU Council of Ministers as well as the priorities suggested by the European Employment Taskforce headed by Wim Kok.

Economic activity of population or participation in the labour market is increasing and in 2004 it was 69,6% (for inhabitants aged from 15 to 64), which falls a bit short of the EU average. Female economic activity (65,3%) exceeds the EU average, while male participation in the labour market (74,3%) falls behind the EU indicator quite remarkably.

On average the level of education among the employed persons is comparatively high in Latvia. In 2004 22,7% of employed persons (in main work) had higher education, 64,3% - secondary education (including vocational education). Every year the number of students is increasing, the proportion of graduate females is also high. However, partially the education which is acquired doesn't correspond to the new requirements of the labour market, thus a part of inhabitants (including those with previously acquired higher education) lack skills necessary for working in perspective and well-paid jobs in such areas as information technologies, communications, marketing or logistics. Inadequate skills of state and foreign

languages also increase the risk of unemployment. The proportion of those studying in engineering sciences programs is relatively low, while there is a tendency of increase in the numbers of students in humanitarian sciences programs.

The employment rate in Latvia within the age group of 15-64 was 62,3% in 2004. As sectors with a traditionally high proportion of employed females have developed more rapidly (like trading, restaurants and other services), an increase in the female employment rates is observed. Female employment rate is comparatively high – 58,4% (in 2003 – 57,9%), even higher than the EU average (in 2003 – 55,1%). Employment rate for males – 66,4% (in 2003 – 66,1%) falls behind the EU average significantly (in 2003 – 70,9%).

Large numbers of job-seekers still cannot find work for more than one year. The long-term job seekers were 43,5% of all job seekers in 2004 (in the age group of 15-74). There is a high proportion of the long-term job seekers in the pre-retirement age (55-64) – 59,2% of the total number of job seekers and especially among males – 64,9%.

### 3.2. Objective 5: extend working lives

**Ensure that, alongside labour market and economic policies, all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers; that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age; and that pension systems facilitate the option of gradual retirement.**

The ideology included in the Latvian pension system is focused on incentives for population in the working age to remain in the labour market as long as possible continuing working after reaching the defined minimum retirement age. The old age pension amount within the NDC PAYG scheme is dependent not only on the accumulated pension capital, but also on the retirement age and forecasted life expectancy after retiring (G in the pension formula).

Gradual increase in the minimum retirement age is carried out in Latvia both for men and women in order to reach 62 years. Men already reached this age in 2003, but for women the gradual increase in minimum retirement age will continue until 2008.

Employment rate in the age group from 55 to 64 is increasing rapidly and in 2004 it reached 48% (in 2003 – 44,1%), which is higher than the EU average (in 2003 – 40,2%). In this age group the employment rate of females also grew, although it is lower than for males (in 2003 by 12,5%), still this indicator for older females exceeds the EU average in Latvia – 38,8% and EU – 30,7%.

Each year the average age, when inhabitants interrupt their economic activity, is gradually increasing (in 2003 this age for males was – 61,36 and for females – 58,34). Although

retirement age is increasing more rapidly for females than for males, there are still differences between both genders as regards this indicator (by 3,02 years). It is forecasted that during next 20 years actual retirement age could reach 63 years for both genders.

Opportunity to opt for early retirement was foreseen in legislation until 1 July 2005. In order to socially protect the persons, who were in pre-retirement age and were not able to integrate into the labour market (due to objective or subjective reasons), the right to claim for early retirement pension was provided by law already during the first years of pension reform. Claiming for early retirement pension results in certain limitations for claimant both in relation to lower amount calculated as well as having no entitlement during periods of work. However, taking into consideration the fact that currently integration into the labour market for the inhabitants in pre-retirement age is not fully ensured (the opportunity to use early retirement has been used by 40% of pensioners on average per year), after having a wide discussion in the society, the Parliament has decided to prolong the possibility for early retirement for 3 more years.

The proportion of job seekers among young people is higher than among older people. In 2004 the proportion of job seekers among young persons in the age group from 15 to 24 years was 18,2% in Latvia, while for persons aged from 55 to 64 years it was 8,3%. Opportunity to find a job in most cases depends on the level of education. The lowest proportion of job seekers is among people with higher education and in 2004 it was 8,7%, but among those with primary education – 22,7% (in the age group 15-74 years). The competitiveness of older unemployed persons in the labour market has been decreased due to inadequacy of skills and knowledge acquired previously, which do not meet the requirements of modern labour market.

Life long learning is important in order to increase the competitiveness of labour force as well as to ensure the adequacy of skills and knowledge enabling to meet the changing requirements and facilitating the integration into the labour market. Persons in the age group of 15-44 years are more often participating in the life-long learning activities. However, the activity of persons in pre-retirement age and older is quite high (at 27,2%) although they mostly use informal educational opportunities. Women of all age groups are more active in acquiring education, qualifications and knowledge.

State Employment Agency carries out various activities for the unemployed (including unemployed persons over 55 years) enabling them to return in the labour market, by offering traditional job placement activities and active employment measures, among these special measures, for instance, provision of social enterprises in the labour market for employing less competitive unemployed persons (including unemployed persons at older age) and subsidized workplaces for unemployed persons of pre-retirement age.

The European Social Fund contributes 119 million LVL during 2004-2006, thus providing a considerable support to employment promotion in Latvia. The investment will be used for

such priority directions as employment promotion, development of qualitative education and life-long learning and reducing of social exclusion.

### **3.3. Objective 6: making pension systems sustainable in a context of sound public finances**

**Reform pension systems in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time sustainability of pension systems needs to be accompanied by sound fiscal policies, including, where necessary, a reduction of debt. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds.**

The stability of pension system in Latvia is facilitated by the way the system is designed. It can ensure more stability in relation to possible demographic and economic fluctuations. Consolidation of an NDC PAYG scheme and a funded pension scheme within the framework of old age pension system allows to minimize the risks typical for each of these schemes.

Stability of the present pension system in Latvia is being provided by pension calculation formula, where the amount of pension is dependent on the social insurance contributions made and planned period of pension disbursement (calculation principle – notionally accumulated pension capital divided by the forecasted life expectancy after retirement).

State pension system is also being stabilized by the condition that indexation (adjustment) of pension capital and of pensions already granted within the first tier is also flexible. In order to provide the stability of the value of pension capital for the first tier during the whole social insurance contribution period, it is being indexed in accordance with the increase in insurance contribution wage. These indexes are directly dependent on the increase in social insurance contributors' wages as well as in the numbers of contributors during reference periods. However, indexation of pensions already granted is directly dependent on the level of inflation in the country. As from 2002, in addition to indexation of low pensions according to the consumer price index, they are adjusted also in accordance with the increase in social insurance contribution wage.

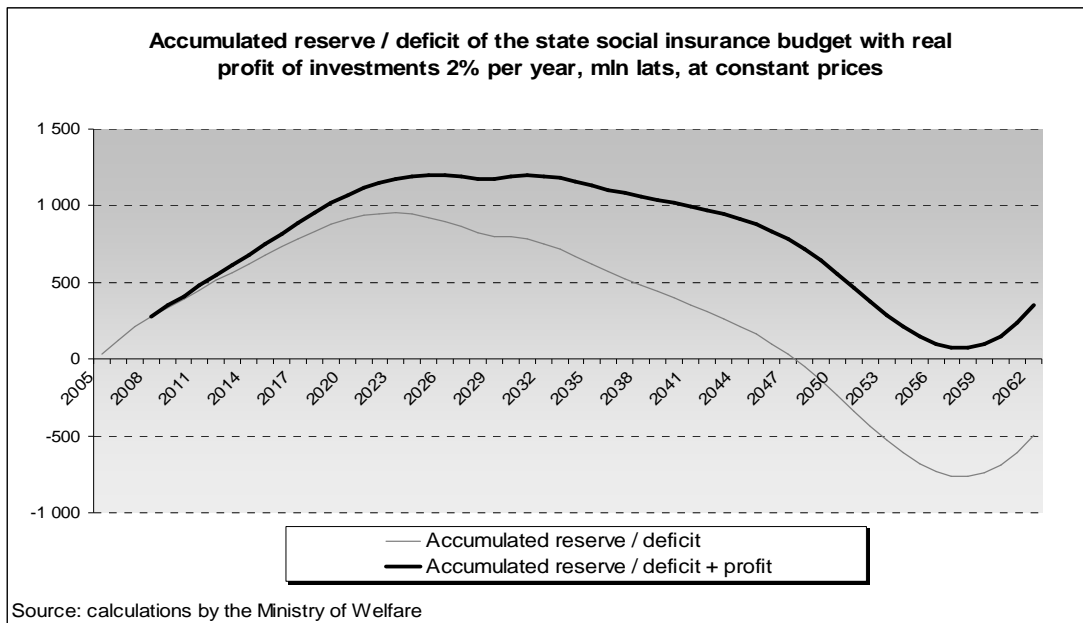
There was a financial surplus in the social insurance budget already in 1995 and by the end of 1997 the budget reserve accumulated reached 26 millions of LVL. Amendments to the pension legislation of 1998 (providing for an increase in average pension amount) and simultaneous consequences of Russian crisis to the Latvian national economy had substantial impact on the social insurance budget. From 1998 and during the following years the social insurance budget revenues and reserve accumulated were inadequate to cover the expenditure. During the period of 1998 – 2001, special social insurance budget was formed with a deficit in every current year and, in order to provide the payment of social insurance benefits in the amounts and periods set by law a loan from the state main budget was taken. Due to the economy growth, the improvement of work of different bodies responsible for

control, the increase in the participation of population in the formal labour market as well as the positive demographic situation, the year 2002 ended with 1,57 million LVL surplus and during 2003 the budget's debt recovery procedure was started. It is planned to repay the debt totally by 2007.

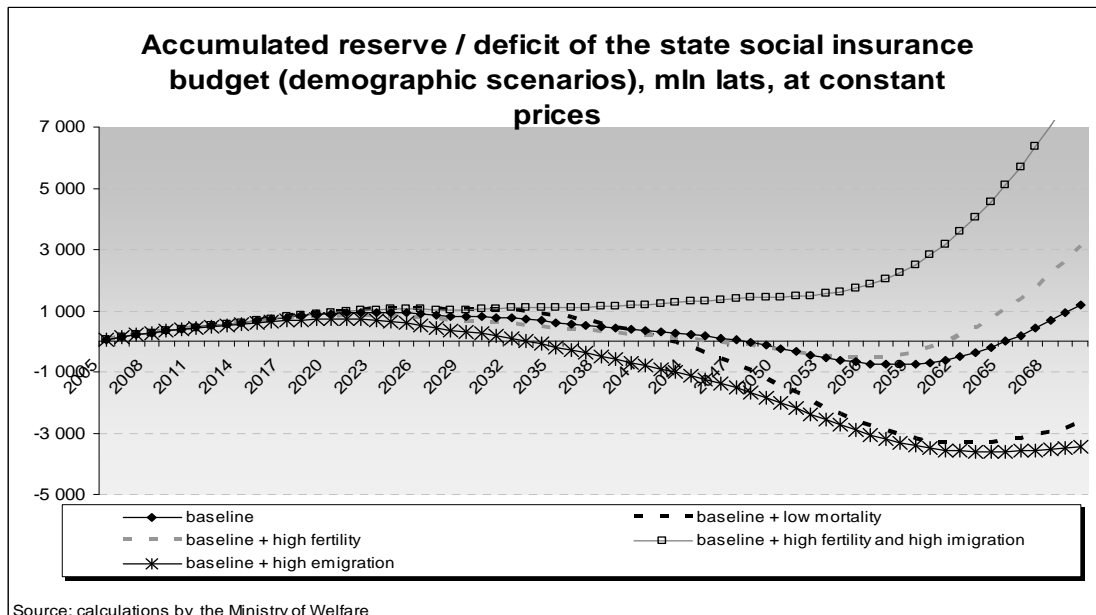
According to the budget forecasts for nearest 15 to 20 years positive fiscal balance and asset formation in accumulated reserve can be expected. Therefore, the accumulation of the social insurance budget's revenues must be started in order to use the reserve for covering the budget deficit in the following years. That means that the surplus of social insurance contributions, created during the demographically favourable periods, will be directed to a reserve fund, but later – during demographically or otherwise unfavourable years - the assets accumulated will be withdrawn and used in order to compensate the deficit in the insurance budget.

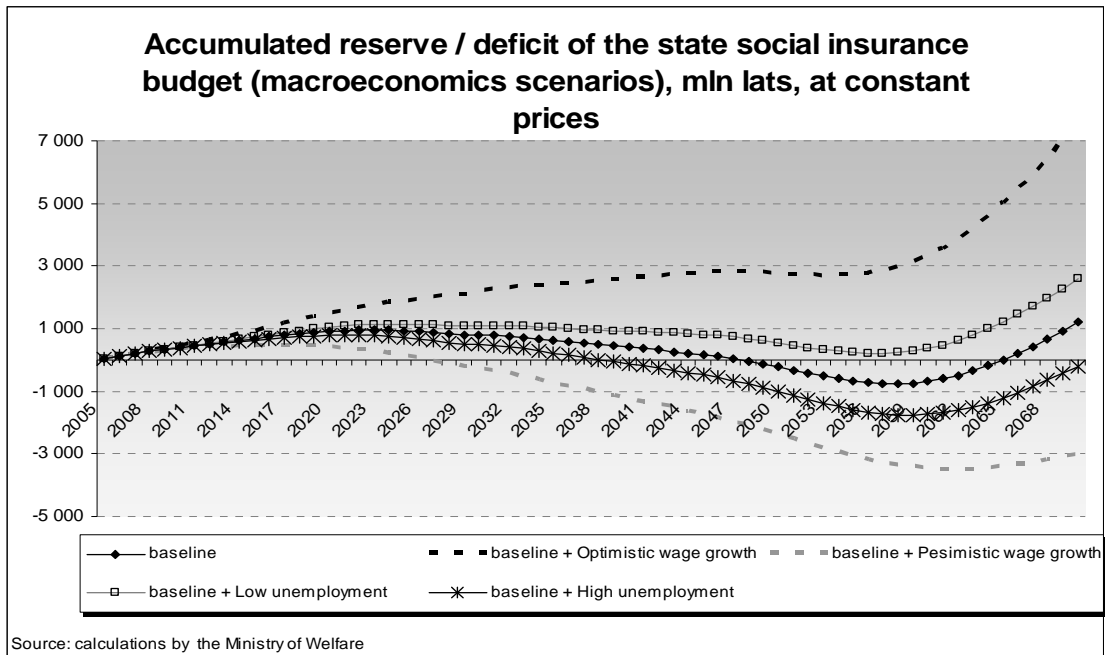
In accordance with the budget forecasts it will be possible to make transfers to the reserve fund in the nearest 15 – 20 years, but afterwards there will be a need to gradually withdraw the assets from the reserve fund in order to cover social insurance budget's current deficit. By creation of reserve fund as well as any long-term financial reserve, the issue of securing it from losing real value under the influence of inflation is essential. Assuming that average inflation is only 2,5% per year, the real value of the accumulated financial resources during 10 year period decreases to 78%, but during 20 years – to 60% from the initial value, but if the inflation is higher the devaluation is also remarkably higher.

Protection of the financial resources against the risk of inflation is possible by making investment in financial market instruments, which provides rate of return not lower than the average inflation rate. Moreover, investment of financial resources can provide not only the protection against inflation, but also ensure real profit (investment rate of return being higher than the average level of inflation), which may form an important financial addition to the reserve fund. Calculations show that if profitability of the reserve fund's assets investment would exceed the inflation rate in the corresponding period only by 2% per year on average, this would be adequate to cover the forecasted deficit in the social insurance budget from reserve fund's financial support, so there would be no need to involve state budget. Certainly, the accumulation of social insurance contribution surplus in the reserve fund and the investment of assets must be accompanied by provision of strong risk control.



Under various demographic and macroeconomic scenarios the financial situation of the social insurance system and expected future risks have also been evaluated. Optimistic scenarios with higher rate of wage growth, lower unemployment rates or favourable demography (higher birth rate and immigration) show that during the forecasted period the social insurance budget operates without a deficit. In the case of other scenarios the surplus accumulation period followed by deficit period is observed in future and the source for covering the deficit as it was mentioned before, is accumulation of financial resources in the reserve fund. Expenditure for old age pensions (% from GDP) in the period from 2000 to 2050 will increase by 0,1 percentage point, where the increase of expenditure will be caused only by the increase in demographic burden, while due to simultaneous influence of other factors the expenditure will decrease.





### 3.4. Objective 7: adjust benefits and contributions in a balanced way

**Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter.**

Within the framework of the NDC PAYG scheme social insurance contributions made by the employed persons for pension insurance are used for paying out pensions to current pensioners. Pension system provides incentives to extend the working life, as a result the burden on the employed decreases.

The total number of pensioners has decreased by 51,2 thousands or 8,0% since the reform was introduced (including the number of old age pensioners – by 22,3 thousands or 4,4%). The number of newly granted pensions in the mentioned period of time has also decreased – almost twice. At the same time, increase in the number of socially insured persons by 11,9% has brought about a significant decrease in the burden. If in 1996, each 1000 of social insurance contribution payers had to provide support for 659 pensioners, then in 2004 – for 442 pensioners. Decrease in the number of old age pensioners is brought about not only by the demographic changes, but also by the gradual increase in the retirement age as well as by postponing of the retirement..

Within the NDC PAYG scheme, the pension calculation formula provides that when the pension is being granted the pension capital, accumulated during working life, is spread equally over each year of the whole period of pension disbursement. Together with the increase in life expectancy of population the planned time period of old age pension

disbursement applicable for the calculation of pension (G), by which the pension capital is being divided, is also gradually increasing, thus providing the adequacy of financial resources during the whole period of pension disbursement.

Since the beginning of the reform the rate of social insurance contributions has decreased from 38% to 33,09%, where the employer pays 24,09% and the employee - 9%. As working pensioners are not being insured against the risk of unemployment, the contribution rate for them is lower than in general case. As forecasts of social insurance budget show, the current contribution rate is adequate for ensuring the payment of pensions in future provided that the reserve fund is created.

### **3.5. Objective 8: ensure that private pension provision is adequate and financially sound**

Ensure, through appropriate regulatory frameworks and through sound management, that private and public funded pension schemes can provide pensions with the required efficiency, affordability, portability and security.

Contribution of the state mandatory funded pension scheme and private pension scheme to the provision of adequacy and financial sustainability of pensions depends on participation rates in the scheme, contribution rates as well as real rate of return from investments (taking into consideration the inflation and administrative costs).

The state supervision over the state mandatory funded pension scheme and private pension scheme is entrusted to the Financial and Capital Market Commission, which grants (or nullifies) licenses to managers of state funded pension scheme's funds, to holders of funds and registers prospects of state funded pension scheme's investing plans as well as grants licenses (or nullifies licenses) to private pension funds and pension plans. The Financial and Capital Market Commission has rights, in order to supervise the operations of fund managers, fund holders and further activities of pension funds, to perform thematic inspections, request information and documents on their activity as well as perform full audit.

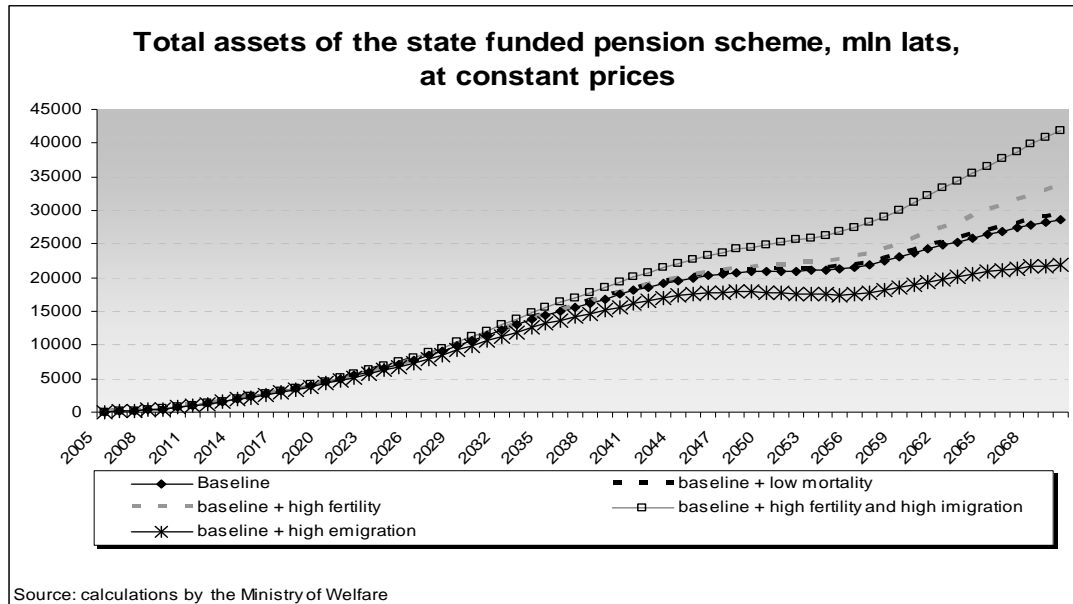
In the process of development of the state funded pension scheme and private pension scheme, strict and detailed rules and restrictions for funds investment were elaborated and approved. Strict quality requirements were defined in relation both to loan and capital bonds (ratings, quotation in the official list of stock exchanges etc.). Financial and Capital Market Commission supervises conformity of the investments portfolio to the requirements defined by law. The investment policy of state funded pension scheme can be evaluated as conservative, because it allows to invest only up to 30% of funds into capital bonds (shares), investments with disbursements in unmatched currencies are allowed not more than up to 30%. The investment policy of private pension scheme is much more liberal, limitation for



investment into capital bonds (shares) and limitations with liabilities in unmatched currencies do not exist.

The administration of state funded pension scheme's assets is being performed by the State Treasury (until 2003 the sole manager of funds) and by private assets managers (since 2003). The assets of this scheme are being invested in 19 investing plans, which are supervised by 8 assets managers. Each participant of the scheme has a right to choose the manager of his assets once a year and the offered investing plan – twice a year. Currently, there are 7 plans offered, which follow conservative policy (pension assets are being invested into securities with the lowest risk degree), 3 balanced plans and 9 active plans (assets are being invested into shares). In 2003 61% of all scheme participants chose conservative investment policy for their pension capital, 36% - active and 3% - balanced.

Until 31<sup>st</sup> December 2006 2% from person's state social insurance contribution base will be directed to pension state funded scheme. From the beginning of scheme operation till 31<sup>st</sup> December 2004, 44,8 mill. LVL of scheme's assets are entrusted to the assets managers for management, 70,3% of them - to private funds managers. When there is an increase in the number of scheme's participants and in contributions made to the scheme, scheme's assets also increase (with rate of return - 4,5% per year) and in 2004 these assets amounted to 0,6% of GDP, 85,1% of them were invested in Latvia and 14,9% - abroad. As forecasts using different demographic scenarios show, scheme's funds in the forecasted period will increase rapidly and according to the basic scenario will reach 95% of GDP.



It is expected that first participants of this scheme will reach retirement age only approximately in 2014, when the amount of accumulated pension capital will depend on the amount of contributions paid, the length of participation in the state funded pension scheme and on the results of chosen investing plan's operation.

State funded pension scheme's assets are being saved separately from the holding bank's and fund manager's own funds and actives, thus ensuring safety of investing plan funds in case of insolvency.

The State Social Insurance Agency (SSIA) administers the state funded pension scheme, representing the scheme's participants in relations with assets managers. SSIA enters into agreements with assets managers relating to the scheme's funds supervision, provides regular money and information flows between SSIA, fund managers and holders of funds, publishes information about the state funded pension scheme and results of its operations. Individual accounts are created in the SSIA for all the participants of the state funded pension scheme, where contributions made to the scheme and funded pension capital accumulated are being registered. The confirmation about the registration of in the state funded pension scheme, extract from scheme participant's account about each operating year and information about performed transactions with pension capital are sent to each participant of the scheme.

Within private pension scheme, in 2004 5 private pension funds were operating in Latvia – 4 open and 1 closed, offering 12 pension plans with 39 thousands of participants. In 2004 88% from the contributions to pension funds were made by employers and 12% - by individual participants. The amount of contributions made compared to 2003 has increased for 3,3 times. Only defined contribution pension plans without biometric risks coverage and guaranteed rate of return are offered in Latvia. Pension plan participants themselves bear all the risks in relation to the investments in the pension plan. There is a risk that if unfavourable market situation occurs or fund manager makes unsuccessful investment portfolio, the paid capital in a defined period of time may decrease. In 2004 the investment portfolio of pension plans was 25,4 mill. LVL or 0,3% of GDP (with average rate of return per year 5,4%), 79% of them were invested in Latvia and 21% - abroad. The investment policy of private pension plans is relatively conservative with no considerable investments in shares (15%), for the most part investing in the loan bonds (49%) and time deposits in the credit institutions (33%).

As the recognition of private pension funds and state funded pension scheme's offered pension plans in the society is increasing, the number of participants in pension plans is also gradually growing and accordingly also the amount of contributions made. As the amount of pension plans' actives grows, wider opportunities for funds investment and diversification appear. In the beginning, when pension plans were new and little known financial tools, there was a tendency for investment strategies of pension plans to be notably conservative, mainly oriented on investment of the pension plan participants' financial capital in relatively low risk actives, having relatively low rate of return. By raising of the number of pension plan participants and also, due to the increase of knowledge in the area of investments, pension funds have begun to offer pension plans with different investing strategies, providing a wider choice of opportunities for participants of pension plans, for example, to take a higher investment risk in order to receive higher capital pay back. Also pension funds themselves have accumulated adequate experience in order to offer more and

more qualitatively elaborated pension plans to their participants and to satisfy different requirements and needs of individual participants.

The legislation, in accordance to which private pension funds are operating, is being regularly re-viewed and amended in order to provide the adequacy of legislative basis to the current situation (for example, when a fixed exchange rate of LVL to EUR was defined, amendments in legislation were made to cancel limitations for investments in EUR) and to protect the interests of the pension plan participants. Legislation is being regularly amended also in order to bring it into conformity with the corresponding EU directives.

Pension plan participant has unconditional right to the whole additional pension capital, accumulated in his account. Pension plan participant's contributions or contributions made on his behalf, are to be immediately (not later than on the next working day) transferred to the individual account of pension plan's participant. Under no circumstances additional pension capital accumulated on the individual account can become a property of the assets manager, the assets holder or the employer. As participation in the private pension funds has no age limitations, as well as no qualification period, the payment of additional pension capital was begun already in 2000 (in cases of reaching 55 years of age or death), which has increased from 0,001% of GDP to 0,01% of GDP in 2004.

Management of private pension fund is being performed by the Pension Fund Board, which is responsible for the conformity of pension fund operations to the legislative requirements, statutes and licensed pension plans. Board provides free access to the pension plan participants to the information about investment policy of the pension plan, at least once a year it informs each pension plan participant in writing about the situation in the individual account as well as informs pension plan participants about any changes.

Pension plan participants must consider that defined part of contributions made to the scheme will be directed to cover the administrative expenses (remuneration for fund manager, holding bank etc.). In 2004 administrative expenses of the state funded pension scheme amounted to 1,1% of annual average net actives, while in private pension schemes – 0,8% of annual average net actives.

### **3.6. Strategy to achieve the goals**

As an EU member state, Latvia participates in achieving the Lisbon goals<sup>1</sup> and has accepted and will implement the integrated guidelines for the economic and employment policies. Taking into consideration the complex nature of employment and labour market development, which is directly affected by the development of entrepreneurship and by business-friendly environment, supply of education corresponding to the labour market

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<sup>1</sup> Goals defined by the EU Council in Lisbon for the year 2010: level of employment – 70%, including for females – 60%, as well as intermediate goals defined by the EU Council in Stockholm for the year 2005: level of employment – 67%, including for females – 57%, as well as in the year 2010: level of employment for persons in age group 55-64 years – 50%.

requirements, accessibility to education in the context of life-long learning, in order to create a labour force which is mobile, professional and able to adapt as well as to achieve the Lisbon goals in the field of employment, an integrated and complex approach is necessary for solving the above mentioned issues in the state, as well as support from the EU structural funds (**4<sup>th</sup> goal**).

Current pension system encourages people to increase the actual retirement age and to continue working after reaching the defined minimal retirement age. Simultaneously, total inclusion of all working-age population into the labour market must be facilitated by reducing the share of “grey-sector” economy and the rate of unemployment both in regions and in the country. To tackle the problems of population ageing, state institutions in cooperation with social partners and non-governmental organizations should carry out activities supporting the increase in employment among young and older workers as well as facilitate the return of the long-term unemployed and economically inactive into the labour market (**5<sup>th</sup> goal**).

Taking into account the tendencies in the development of demographic situation and its consequences for the economic growth, balanced social security policy and financial planning are of great importance, in order to provide the long-term stability of social security system. The method of old age pension calculation in the NDC PAYG scheme stabilizes the system in relation to changes in life expectancy without compensating fluctuations in the demographic burden on persons of the working age. This should be compensated by the state social insurance reserve fund. Without such a fund the maintenance of pension system’s stability in the long-term perspective is practically impossible, for example, during the years, when the relatively large generation of the employed persons (born in 1960-ies) will retire. In connection with formation of this fund, the elaboration of corresponding legislative basis is carried out (**6<sup>th</sup> goal**).

The pension system, introduced in Latvia, is capable in the long-term perspective to retain unchanged the rate of state social insurance contributions, and it is able to secure the employed persons from the rise of social insurance contribution burden. In order to improve demographic situation in the country simultaneous efforts should be taken to create family-friendly and safe socio-economic environment (**7<sup>th</sup> goal**).

As population’s purchasing power is relatively low, inhabitants choose to spend their income on the short-term daily needs, but are not investing in the long-term savings, creating additional pension capital. However, basing on current tendencies, it is possible to expect that by increase in purchasing power of population and recognition of pension funds, the amount of individual contributions to private pension funds could increase. However, this also means that people should become more educated in the financial and investments fields in order to be able to choose the most relevant pension plan with the most favourable investment strategy taking into consideration, that they take all the risks linked to investments themselves. As currently pension funds industry is in the growth phase, the expenditure of pension funds exceeds revenue. Consequently, in the current phase it

wouldn't be possible to forecast a decrease in deductions for the administrative costs. However, in the longer perspective the expenditure for covering the administrative costs could decrease (**8<sup>th</sup> goal**).

#### **4. MODERNISATION OF PENSION SYSTEMS IN RESPONSE TO CHANGING NEEDS OF THE ECONOMY, SOCIETY AND INDIVIDUALS**

Latvian pension system is adequate to meet the changes in society and labour market.

##### **4.1. Objective 9: adapt to more flexible employment and career patterns**

**Ensure that pension systems are compatible with the requirements of flexibility and security on the labour market; that, without prejudice to the coherence of Member States' tax systems, labour market mobility within Member States and across borders and non-standard employment forms do not penalise people's pension entitlements and that self-employment is not discouraged by pension systems.**

Almost in all sectors of national economy there is a tendency that growth of the sector does not promote significantly the increase in employment rate. During the post-privatisation period the competition intensifies in the private sector. Under these circumstances the enterprises are forced to search for ways to minimize costs and to increase the productivity. In most cases, minimization of employment costs is seen as one of the most important ways to minimize total costs. This often results in decrease in the number of employed persons.

Different employment rates are observed in various regions of Latvia. In 2004 the highest employment rate was in Riga region (67,3%), but the lowest – in Latgale region (53,6%). The geographic mobility of labour force (inside the country) is minimal due to inadequate transport infrastructure, high rental costs and not highly developed housing infrastructure. Therefore there are differences also in the amounts of pensions among the regions. The highest pension amounts in 2004 were in Riga region – 81,40 LVL, but the lowest - in Latgale region – 71,73 LVL. At the same time, by Latvia's accession the EU, free movement of workers is promoted as well as totalization of all employment periods for pension entitlement purposes in cases a person has been working in several member states.

The redistribution process of labour force among national economy's sectors continues in Latvia: during the last years the number of people working in agriculture and industry has decreased, meanwhile, the number of people working in building and service sectors has increased.

The proportion of the employers and the self-employed persons is low (including un-paid persons, who help other family members) – in 2003 in Latvia it was 12,4% (in the age group of 15-64 years), compared to the EU average - 15,6%. It has to be noted that the proportion of women among the entrepreneurs is small.

If compared to the EU average indicators, there are relatively high numbers of standard working hours per week in Latvia (in 2003 - 42,0 hours, in the EU – 38,0 hours). The

number of employees, who work part-time, is relatively low, although this is important support for the reconciliation of family and working life. For example, in 2003 only 9,6% of employed persons in Latvia were employed part-time (in the EU average – 15,6%).

The comparatively high tax burden (effective tax rate – 40,8%) doesn't encourage the job seekers to accept jobs with low and medium wages, instead they tend to work in "grey-sector" economy, which has reached a comparatively high level in Latvia. Frequently labour contracts are not concluded with employees and wage is paid in "envelopes". In most cases work is not fully declared: although employees are employed on the basis of labour contract with officially declared and paid wages, they receive additional remuneration in "envelopes", from which no taxes are paid and as a result of this situation, the amount of pension earned is quite low. In 2004 16,3% of all newly granted pensions were guaranteed pensions (state guarantees pension amount on the level of a defined minimum) (for males – 12,4% and for females – 23,5%).

The employment rate is low for disabled persons. Integration of the disabled into the labour market is slow due to the lack of employers' motivation, inadequate environment (including workspace) for the specific needs of disabled people as well as relatively low levels of education and skills in this group. During the period, when a disabled person doesn't work, the social insurance contributions are made from special budgets for disability, maternity and sickness on behalf of him and these periods are taken into account for calculation of old age pensions. Still, it frequently happens that the old age pension awarded according to the calculation is lower than the amount of disability pension received earlier. In such a case the pension law stipulates that old age pension calculated during the period of disability can not be smaller than the disability pension received earlier.

The qualification period, which is defined in legislation for acquiring rights to receive state pension, is the following: for old age pensions - 10 years, for disability pensions – 3 years. However, provisions included in the legislation stimulate to accumulate of longer insurance record: the longer will be the insurance record with social insurance contributions made, the higher will be the pension amount. Certain privileges in relation to the old age pensions are also dependent on the length of insurance record. The average insurance record in 2004 was 33 years, whereas for old age pensions – 35 years.

NDC PAYG scheme is flexible in relation to various forms of employment, for example, in the case of part-time work as well as in cases, when the employer hasn't paid the social insurance contributions on behalf of the employee (see chapter 2.3.), the employment period is included into the insurance record and pension capital is calculated basing on income.

#### 4.2. Objective 10: meet the aspirations for greater equality of women and men

**Review pension provisions with a view to ensuring the principle of equal treatment between women and men, taking into account obligations under EU law.**

Notwithstanding the relatively high levels of the economic activity of the women, the observance of gender equality principles can be evaluated as low, because there are significant differences both in relation to remuneration and in relation to the positions taken by men and women.

Political and economic changes that took place in Latvia have affected men and women differently. General economic status of women is worse than that of men. Women face unequal opportunities in the labour market more often than men. Comparatively small number of women are employers, and the average gross monthly wage for women is smaller than average wage for men in all occupations. There is comparatively small number of women among managers of small and medium enterprises (SME). Basing on the forecasts that SME will provide new working places and regional development, it is not acceptable that only 1/3 of SME are managed by women. Women are facing discriminative criteria (like age, family status or appearance criteria) by applying for job more often than men.

Major part of women are employed in governmental/municipality institutions. Their choice in favour to these institutions, despite the comparatively low remuneration, is influenced by work place stability and social guarantees. Stability and social guarantees are essential factors, because women in comparison with men are taking more care for children. As a result, unequal distribution of duties in the family influences the economic situation of the women for a long period of time.

The feminisation of poverty is also typical to Latvia. Women are affected by the risk of poverty more than men. As women on average receive lower wage (on average 83% of men's wage), are outside the labour market during pregnancy and parental leave, take care after sick and old family members, work part-time more often than men, lower social insurance contributions are made on behalf of women. It results in lower pensions (in 2004 the average amount of old age pension for women was by 11,28 LVL lower than for men). Situation is being worsened by the fact that many women are single (divorced, widows) and their pensions are often inadequate for satisfying their needs (rental, food, medicine and other costs).

The return to the labour market of women after parental leave is being hampered by the depreciation of skills and qualification after the parental leave as well as by low accessibility of child care institutions (especially in Riga). Employers are of the opinion that the care for children decreases the productivity of the women and at the same time they are not motivated to allow women to work part-time or at home (by using PC etc.). After the parental leave women are more active than other groups of population in using active



employment measures and job-placement services offered by the state. Childcare period, until the child reaches 1,5 year age, is included in the social insurance record.

As forecasted life expectancy for women is much higher than that for men, the planned period of old age pension disbursement (G) is being calculated as an average indicator for both men and women, thus ensuring gender equality and solidarity as well as stability of the system.

Within NDC PAYG scheme (together with accumulated funded pension capital), in case of participant's death, the whole pension capital, registered until the death of the scheme's participant, is taken into account for calculation of survivor pensions for the deceased scheme's participant's family members, who are incapable of work. However, by purchasing of the life insurance policy for accumulated funded pension capital, there is an opportunity to make co-insurance (mentioning the spouse). Within private pension scheme, in the case of participant's death, rights to the accumulated pension capital transfer to his heirs including also the surviving spouse.

#### **4.3. Objective 11: demonstrate the ability of pension systems to meet the challenges**

**Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. Develop reliable and easy-to-understand information on the long-term perspectives of pension systems, notably with regard to the likely evolution of benefit levels and contribution rates. Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.**

The supervision is essential in order to evaluate, whether the pension system chosen by Latvia is functioning according to its goals and what are the administrative costs for achieving them. By supervising, the main attention has to be paid to the impact of system operation on the client. It is important to find out the levels of client's satisfaction, by performing annual polling of clients. The evaluation of current situation analysis and further strategy is being reflected in annual reviews as well as regular work on evaluation of pension system's long-term stability is taking place (using long-term prognosis model). The results are taken into account in policy planning, mid-term budget formation and informative reports presented to the government and to international institutions.

Individual account is opened for each participant of the pension scheme where information concerning operations with pension capital is registered, and this information is sent to each participant of the scheme once a year. Additional information about every significant change is also provided. Annual reviews prepared by fund managers, which give true and clear overview of the management of pension scheme, financial status, as well as results of operations, form an important source of information.

Social policy goes together with state support and protection for people in need of this legal certainty of individuals in this area has to be especially protected. The legal framework in the sphere of social policy should be sufficiently stable and unchanging for individual to be able to safely plan his future. In the legislation, regulating pension system since 1996 lots of amendments have been made (for example, to pension law, which regulates state notional contribution defined pension scheme, amendments have been made for already 10 times). Although changes of a conceptual character weren't made by these amendments, there still is a risk of maintaining the confidence level in the society in relation to the pension system's stability.

The involvement of society and non-governmental organizations in the policy planning by Latvia's government has become an integral part of social policy formulation. Before decision-making as well as during the process of policy formulation consultations with representatives from non-governmental organizations and social partners take place. In order to get to know the opinion of population, the discussions in the public sphere are carried out, informing inhabitants about changes planned in the social security policy and legislation, thus giving the possibility for the society to express its view on particular issues. Informational flow on amendments made to the legislation is organised in order to explain to the inhabitants their rights and responsibilities. Information for the society about actualities and changes in the social security policy is mostly provided via mass media (printed press, radio, TV). Recently internet web pages have become even a more important informational channel. Information available for people there is not only useful, but also presented within an interactive environment, in order to provide opportunities to express opinions by sending mails to the ministry's specialists, participating in discussions and presenting advice on questions of interest for a person or society in general. The regular meetings with inhabitants are carried out. In these meetings people may ask questions to the responsible officials and offer their opinion on necessary changes.

#### **4.4. Strategy to achieve the goals**

Minimal insurance record necessary for entitlement to pension has been defined in the NDC PAYG scheme. The scheme is flexible in relation to various forms of employment, does not restrict self-employment and secures rights to pension in cross-border situations. At the same time, the adaptation of flexible employment forms should be facilitated in the state, the work on the reduction of un-declared work should be continued as well as mobility of population should be encouraged (**9th goal**).

Within pension system gender equality is provided in relation to minimum retirement age to planned period of pension disbursement (G), to opportunities of using the pension capital accumulated, however, there is still inadequate understanding of gender equality issues among employers and society in general. Better understanding should be facilitated as well as reconciliation of working and family life achieved (**10<sup>th</sup> goal**).

Although the information levels in society is increasing every year, the work for facilitation of society's (especially among youth) understanding of the today's investments importance for the future pension should be continued (**11<sup>th</sup> goal**).

## CONCLUSIONS

The report evaluates the pension system developed in Latvia basing on the EU's 11 common objectives defined by the EU Council in Laeken in December 2001. Towards this end a comprehensive and detailed analysis of the current socio-economic situation as well as demographic and socio-economic challenges for the short-term and long-term has been carried out.

Latvian pension reform, notwithstanding the difficulties of transitional period, has been completed and (in comparison to the pension system, which operated before the reform was started (till 1996) and faced the exhaustion of funds necessary for pension disbursements) it has various advantages: it is financially stable in the long-term perspective; it, in spite of the high and increasing demographic ageing of adult population in future, is able to ensure pension payments and regular indexation; it is able to retain unchanged the rate of state social insurance contributions in long-term and no further increase is envisaged. Therefore, the pension system, which is able to perceive demographic fluctuations in a maximally flexible way and provide long-term stability in conditions of progressive population ageing, has already been created in Latvia.

The new pension system is flexible in relation to retirement age (because a person can retire at any age, which is not earlier than prescribed in the law regulating the corresponding scheme's operation) and in relation to the ways of pension capital accumulation (because it covers NDC PAYG scheme, and schemes, where funds are being invested in the financial capital market), in relation to payment of pensions, providing state mandatory pension and, un addition, life annuity pension, which is offered by life insurance companies as well as payment of capital accumulated in private pension funds.

Taking into account the tendencies in the demographic situation and their impact on economic growth, a balanced social security policy and financial planning is essential, in order to provide the stability of social security system in the long-term perspective. The method of old age pension calculation in the inter-generation solidarity scheme stabilizes the system in relation to changes in life expectancy without compensating the fluctuations in the demographic burden for persons in the working age. This has to be compensated by the state social insurance financial resources' reserve fund. Without such fund the maintenance of pension system's long-term stability is practically impossible, for example, during the years, when a relatively large generation of the employed (born in 1960-ies) will retire. In relation to the formation of the fund, the elaboration of legislative basis is carried out.

The ideology of the Latvian pension system is focused on incentives for the working-age population to remain in the labour market as long as possible, continuing working after reaching the minimum retirement age set by law. The old age pension amount within the NDC PAYG scheme depends not only on the pension capital accumulated, but also on the retirement age and forecasted life expectancy after retiring (G). The employment rate in the

age group from 55 to 64 years is increasing rapidly and in 2004 it reached 48% (in 2003 – 44,1%) and is higher than the EU average (in 2003 – 40,2%).

However, it is necessary to point out that due to the large share of the “grey-sector” economy, high unemployment rate, low average wage, regional disparities, pension amounts, which depend on social insurance contributions, can often be inadequate, therefore certain activities must be carried out to facilitate the improvement in living standards for pensioners. One of the national priorities is the maintenance of pensioners’ living standards after retirement – provision of pension indexation, adjustment of the lowest pensions more rapidly during the next years, to increase pensions for the pensioners with the longest insurance records, by introducing a monthly supplement for old age pensioners receivers, which could be considered as a partial 4<sup>th</sup> level of pension system (state guaranteed minimum pension during the transitional period, additional to the pension amount individually earned).

## ANNEXES

Table 1

## Demographic indicators

Source: The Central Statistical Bureau of Latvia, Eurostat

	2000	2001	2002	2003	2004
<b>Population</b> (at the beginning of the year)	<b>2 381 715</b>	<b>2 364 254</b>	<b>2 345 768</b>	<b>2 331 480</b>	<b>2 319 203</b>
by age group:					
0-14	428 082	409 760	390 478	372 641	356 505
15-24	339 639	341 405	346 089	352 022	356 976
25-44	676 476	670 338	665 771	660 192	654 786
45-59	437 641	434 372	430 832	432 378	437 487
60-64	146 561	148 109	148 709	144 699	138 061
65-74	226 737	226 800	226 445	227 034	227 762
75 and over	126 579	133 470	137 444	142 514	147 626
ratio to total population, %:					
0-14	18.0	17.3	16.6	16.0	15.4
15-24	14.3	14.4	14.8	15.1	15.4
25-44	28.4	28.4	28.4	28.3	28.2
45-59	18.4	18.4	18.4	18.5	18.9
60-64	6.2	6.3	6.3	6.2	6.0
65-74	9.5	9.6	9.7	9.7	9.8
75 and over	5.3	5.6	5.9	6.1	6.4
<b>Natural population change</b> (per 1000 inhabitants)	<b>-5.1</b>	<b>-5.7</b>	<b>-5.3</b>	<b>-4.9</b>	<b>-5.0</b>
births	8.5	8.3	8.6	9.0	8.8
deaths	13.6	14.0	13.9	13.7	13.8
<b>Total fertility rate</b>	<b>1.237</b>	<b>1.207</b>	<b>1.232</b>	<b>1.286</b>	<b>1.240</b>
<b>Demographic burden</b> (per 1000 inhabitants)					
60 years and over	344	352	355	356	354
65 years and over	221	226	229	233	236
<b>Life expectancy, years</b>					
<b>at birth</b>	<b>70.7</b>	<b>70.7</b>	<b>71.1</b>	<b>71.4</b>	...
males	64.9	65.2	65.4	65.9	...
females	76.0	76.6	76.8	76.9	...
<b>60 years and over</b>					
males	14.8	15.4	15.1	15.1	...
females	21.3	21.5	21.8	21.5	...
<b>65 years and over</b>					
males	11.9	12.5	12.1	12.2	...
females	17.6	17.8	18.1	17.8	...

Table 2

## Macroeconomic indicators

Source: The Central Statistical Bureau of Latvia, Eurostat

	2000	2001	2002	2003	2004
<b>GDP growth rate at current prices, %</b>	<b>10.9</b>	<b>10.3</b>	<b>10.1</b>	<b>11.1</b>	<b>16.4</b>
<b>GDP growth rate at constant prices, %</b>	<b>6.9</b>	<b>8.0</b>	<b>6.4</b>	<b>7.5</b>	<b>8.5</b>
<b>GDP growth rate per capita at current prices, %</b>	<b>11.7</b>	<b>11.1</b>	<b>10.9</b>	<b>11.8</b>	<b>17.0</b>
<b>GDP per capita in purchasing power standards (PPS) EU-25=100</b>	<b>35.3</b>	<b>37.2</b>	<b>38.8</b>	<b>40.8</b>	<b>43.6</b>
<b>Inflation rate, %</b>	<b>2.6</b>	<b>2.5</b>	<b>1.9</b>	<b>2.9</b>	<b>6.2</b>
<b>General government debt</b> (as per cent of GDP)	<b>12.9</b>	<b>14.9</b>	<b>14.1</b>	<b>14.4</b>	<b>14.4</b>
<b>Public fiscal surplus/deficit</b> (as per cent of GDP)	<b>-2.8</b>	<b>-2.1</b>	<b>-2.7</b>	<b>-1.5</b>	<b>-0.8</b>
<b>Average monthly gross wages and salaries of the employed in the economy, lats</b>	<b>150</b>	<b>159</b>	<b>173</b>	<b>192</b>	<b>211</b>
growth rate, %	6.1	6.5	8.5	11.4	9.6
<b>Employment rate, %</b>	<b>57.5</b>	<b>58.6</b>	<b>60.4</b>	<b>61.8</b>	<b>62.3</b>
<b>Unemployment rate, %</b>	<b>13.7</b>	<b>12.9</b>	<b>12.6</b>	<b>10.4</b>	<b>9.8</b>

Table 3

## Indicators describing economic inequality in Latvia

Source: The Central Statistical Bureau of Latvia, Eurostat

	2000	2002	2003
<b>Gini coefficient, %</b>	<b>34</b>	<b>34</b>	<b>36</b>
<b>Inequality of income distribution</b>	<b>5.5</b>	<b>5.5</b>	<b>6.1</b>

Table 4

## Indicators describing risk of poverty in 2002

Source: CIRCA

Risk of poverty (total), %	16.0
<b>males</b>	<b>16.0</b>
<b>females</b>	<b>16.0</b>
People aged 60+	11.0
<b>males</b>	<b>8.0</b>
<b>females</b>	<b>12.0</b>
People aged 65+	10.5
<b>males</b>	<b>6.1</b>
<b>females</b>	<b>12.6</b>
People aged 75+	13.0
<b>males</b>	<b>5.0</b>
<b>females</b>	<b>15.0</b>
Risk of poverty by household type , %	

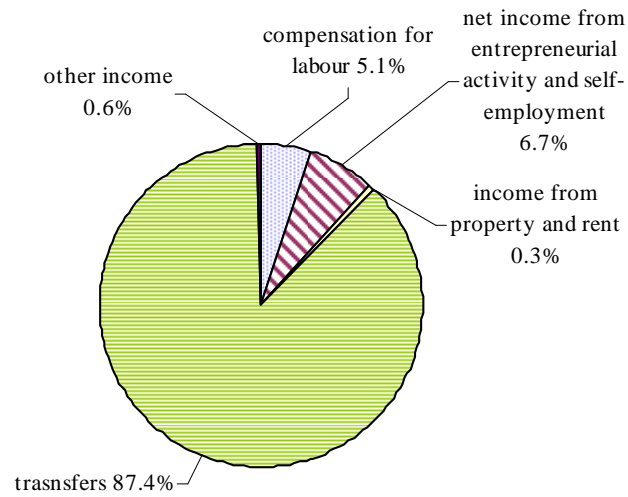
Living alone at age 60+	18.0
<b>males</b>	<b>22.0</b>
<b>females</b>	<b>17.0</b>
Living alone at age 65+	17.0
<b>males</b>	<b>18.0</b>
<b>females</b>	<b>17.0</b>
Living alone at age 75+	18.0
<b>males</b>	<b>...</b>
<b>females</b>	<b>19.0</b>
Risk of poverty by housing tenure status, %	
People aged 60+	
<b>owner occupied</b>	<b>10.0</b>
<b>rented</b>	<b>18.0</b>
People aged 65+	
<b>owner occupied</b>	<b>10.0</b>
<b>rented</b>	<b>15.0</b>
People aged 75+	
<b>owner occupied</b>	<b>12.0</b>
<b>rented</b>	<b>14.0</b>
Risk of poverty at different income thresholds, %	
40% of median	
total	5.0
<b>at age 60+</b>	<b>1.0</b>
<b>at age 65+</b>	<b>1.0</b>
<b>at age 75+</b>	<b>1.0</b>
50% of median	
total	9.0
<b>at age 60+</b>	<b>4.0</b>
<b>at age 65+</b>	<b>3.0</b>
<b>at age 75+</b>	<b>3.0</b>
60% of median	
total	16.0
<b>at age 60+</b>	<b>11.0</b>
<b>at age 65+</b>	<b>10.5</b>
<b>at age 75+</b>	<b>13.0</b>
70% of median	
total	26.1
<b>at age 60+</b>	<b>25.0</b>
<b>at age 65+</b>	<b>27.0</b>
<b>at age 75+</b>	<b>33.0</b>
Risk of poverty for people whose main activity is 'retired', %	
	12.5
<b>males</b>	<b>9.1</b>
<b>females</b>	<b>14.1</b>
Relative risk of poverty	
60+ / 0-59	0.6
<b>males</b>	<b>0.4</b>
<b>females</b>	<b>0.7</b>
65+ / 0-64	0.6
<b>males</b>	<b>0.3</b>



<b>females</b>	<b>0.7</b>
<b>75+ / 0-74</b>	<b>0.8</b>
<b>males</b>	<b>0.3</b>
<b>females</b>	<b>0.9</b>

**Figure 1**

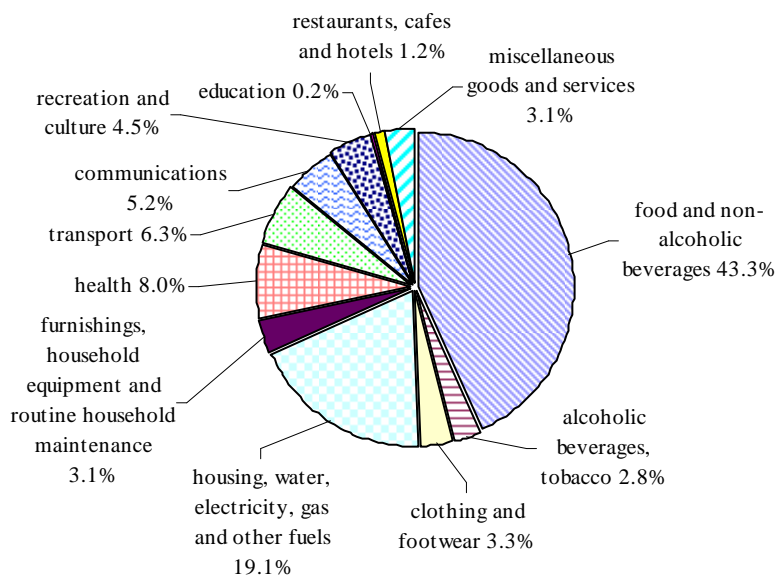
**Structure of disposable income of pensioners household  
in 2003**



Source: The Central Statistical Bureau of Latvia

**Figure 2**

**Structure of consumption expenditure of pensioners  
household in 2003**



Source: The Central Statistical Bureau of Latvia

**Table 5**

**Number of participants in the pension system of Latvia, thsd**

Source: The Financial and Capital Market Commission, The State Social Insurance Agency

	2001	2002	2003	2004
<b>Number of socially insured persons</b>	<b>1 018.8</b>	<b>1 016.2</b>	<b>1 049.0</b>	<b>1 088.7</b>
males	486.0	485.0	500.9	519.3
females	532.8	531.2	548.1	569.4
employees	909.7	914.3	944.3	986.9
self-employed persons	12.8	13.2	18.0	29.5
<b>Number of participants in the state funded pension scheme</b>	<b>274.5</b>	<b>336.0</b>	<b>495.1</b>	<b>633.7</b>
joined voluntarily	26.2	28.1	138.1	224.2
registered obligatory	248.4	307.9	356.9	409.5
males	129.3	160.4	229.9	292.4
females	145.3	175.6	265.1	341.3
<b>Number of pension plan members</b>	<b>17.4</b>	<b>20.1</b>	<b>26.6</b>	<b>39.0</b>
males	-	-	14.1	19.5
females	-	-	12.5	19.5

**Table 6**

**Activity of population and employment, %**

Source: The Central Statistical Bureau of Latvia, Eurostat

	2000	2001	2002	2003	2004
<b>Activity rate (15 to 64 years)</b>	<b>67.2</b>	<b>67.7</b>	<b>68.8</b>	<b>69.2</b>	<b>69.6</b>
males	72.7	72.6	74.1	74.1	74.3
females	62.1	63.2	63.9	64.7	65.3
<b>Employment rate (15 to 64 years)</b>	<b>57.5</b>	<b>58.6</b>	<b>60.4</b>	<b>61.8</b>	<b>62.3</b>
males	61.5	61.9	64.3	66.1	66.4
females	53.8	55.7	56.8	57.9	58.4
<b>Employment rate (30 to 54 years)</b>	<b>74.4</b>	<b>76.1</b>	<b>76.7</b>	<b>78.3</b>	<b>78.8</b>
males	74.2	77.1	77.6	80.5	80.4
females	74.6	75.5	76.0	76.5	77.3
<b>Employment rate (55 to 59 years)</b>	<b>49.0</b>	<b>50.5</b>	<b>58.1</b>	<b>59.6</b>	<b>63.7</b>
males	62.8	61.8	66.4	65.2	72.0
females	38.2	41.7	51.6	55.1	57.2
<b>Employment rate (55 to 64 years)</b>	<b>36.0</b>	<b>36.9</b>	<b>41.7</b>	<b>44.1</b>	<b>48.0</b>
males	48.4	46.2	50.5	51.3	55.8
females	26.7	30.0	35.2	38.8	41.9
<b>Employment rate (60 to 64 years)</b>	<b>23.3</b>	<b>25.0</b>	<b>28.0</b>	<b>31.1</b>	<b>33.8</b>
males	33.3	31.3	36.6	38.8	41.0
females	16.2	20.6	21.8	25.5	28.6
<b>Employment rate (65 to 69 years)</b>	<b>12.6</b>	<b>13.5</b>	<b>14.9</b>	<b>13.8</b>	<b>17.5</b>
males	16.9	17.7	20.8	18.2	21.9
females	9.9	10.8	11.1	11.1	14.6
<b>Employed population by level of education<sup>2</sup></b>					
higher education	21.3	21.4	21.8	20.2	22.7
vocational education and professional secondary education	41.1	38.8	39.4	40.9	39.3
general education	24.8	22.9	24.1	24.8	25.0
basic education	11.2	15.6	13.6	13.2	12.1
less than basic education	1.6	1.4	1.1	0.9	0.8
<b>Employed population in the main job</b>					
full-time workers	88.7	89.7	90.2	89.7	89.6
part-time workers	11.3	10.3	9.8	10.3	10.4
<b>Unemployment rate</b>					
15 to 24 years	21.4	23.1	23.9	17.6	18.2
55 to 64 years	9.6	10.8	9.9	7.9	8.3
<b>Long-term unemployment in % of active population</b>	<b>7.9</b>	<b>7.2</b>	<b>5.7</b>	<b>4.3</b>	<b>4.5</b>
males	8.3	8.1	6.5	4.1	4.8
females	7.5	6.3	4.8	4.6	4.3
<b>Jobseekers by level of education<sup>1</sup></b>					
higher education	8.5	8.3	9.2	8.8	8.7
vocational education and professional secondary education	43.1	36.2	36.4	35.6	35.8
general education	27.2	27.6	28.7	31.2	32.8
basic education or less than basic education	21.1	27.8	25.7	24.4	22.7

Table 7

<sup>2</sup> at age 15 – 74 years

### Replacement rates

(the notional defined contribution pension scheme and the state funded pension scheme)

Source: calculations by the Ministry of Welfare

Retirement year	Cohort	Replacement ratio
Retirement age – 62 years, length of insurance period – 47 years		
<b>2005</b>	<b>1943</b>	<b>62.3%</b>
<b>2010</b>	<b>1948</b>	<b>62.9%</b>
<b>2030</b>	<b>1968</b>	<b>53.4%</b>
<b>2050</b>	<b>1988</b>	<b>55.0%</b>
Retirement age – 62 years, length of insurance period – 40 years		
<b>2005</b>	<b>1943</b>	<b>52.8%</b>
<b>2010</b>	<b>1948</b>	<b>53.0%</b>
<b>2030</b>	<b>1968</b>	<b>44.9%</b>
<b>2050</b>	<b>1988</b>	<b>48.0%</b>
Retirement age – 62 years, length of insurance period – 25 years		
<b>2005</b>	<b>1943</b>	<b>32.6%</b>
<b>2010</b>	<b>1948</b>	<b>31.6%</b>
<b>2030</b>	<b>1968</b>	<b>29.8%</b>
<b>2050</b>	<b>1988</b>	<b>28.6%</b>
Retirement age – 65 years, lengths of insurance period – 40 years		
<b>2005</b>	<b>1940</b>	<b>60.3%</b>
<b>2010</b>	<b>1945</b>	<b>60.5%</b>
<b>2030</b>	<b>1965</b>	<b>51.2%</b>
<b>2050</b>	<b>1985</b>	<b>54.5%</b>

Table 8

### Main indicators of the state social insurance budget, mln lats

Source: The State Social Insurance Agency

	2000	2001	2002	2003	2004
<b>Revenues of social insurance budget</b>	<b>474.6</b>	<b>489.5</b>	<b>536.5</b>	<b>578.9</b>	<b>658.0</b>
<b>Expenditure of social insurance budget</b>	<b>503.8</b>	<b>498.8</b>	<b>534.9</b>	<b>560.6</b>	<b>606.8</b>
<b>Financial balance</b>	<b>-29.17</b>	<b>-9.24</b>	<b>1.57</b>	<b>18.34</b>	<b>51.14</b>
<b>Accumulated reserve / deficit<sup>3</sup></b>	<b>-67.77</b>	<b>-77.01</b>	<b>-75.44</b>	<b>-57.09</b>	<b>-5.95</b>
<b>Social insurance contribution rate (total), %</b>	<b>36.09</b>	<b>35.09</b>	<b>35.09</b>	<b>33.09</b>	<b>33.09</b>
employer's rate	27.09	26.09	26.09	24.09	24.09
employee's rate	9.00	9.00	9.00	9.00	9.00

Table 9

<sup>3</sup> accumulated since 1995

### Indicators describing the notional defined contribution pension scheme

Source: The State Social Insurance Agency

	1996	2000	2001	2002	2003	2004
Pensions total (at the end of the year), thsd	640.7	633.0	620.9	609.7	598.1	589.6
Old-age pensions (at the end of the year), thsd	504.0	513.8	504.8	496.9	487.9	481.7
of which (%):						
males	139.0	30.4	30.7	31.1	31.4	32.0
females	365.0	69.6	69.3	68.9	68.6	68.0
Old-age pensions granted during the year (at the end of the year), thsd	24.0	9.5	11.5	12.3	11.3	13.6
of which (%):						
males	...	67.7	57.6	64.7	60.3	65.6
females	...	32.3	42.4	35.3	39.7	34.4
Actual retirement age, years						
males	60.40	60.29	60.56	60.52	61.06	61.36
females	55.07	56.77	56.70	57.59	57.66	58.34
Old-age pensions expenditure, % of GDP	7.5	7.7	6.9	6.7	6.2	5.6

Table 10

### Projections for 2005, 2010, 2030, 2050 years

Source: calculations by the Ministry of Welfare

	2005	2010	2030	2050
Population (at the beginning of the year)	2 297 102	2 254 648	2 039 888	1 815 622
by age group:				
0-14	329 398	312 398	285 235	245 383
15-24	361 277	312 987	234 989	164 564
25-44	643 728	649 155	500 436	427 686
45-59	454 938	468 187	459 952	306 344
60-64	122 390	124 861	131 903	158 113
65-74	230 542	221 630	245 090	260 465
75 and over	154 829	165 430	182 283	253 068
ratio to total population, %:				
0-14	14.3	13.9	14.0	13.5
15-24	15.7	13.9	11.5	9.1
25-44	28.0	28.8	24.5	23.6
45-59	19.8	20.8	22.5	16.9
60-64	5.3	5.5	6.5	8.7
65-74	10.0	9.8	12.0	14.3
75 and over	6.7	7.3	8.9	13.9
Total fertility rate	1.34	1.43	1.54	1.59
Demographic burden (per 1000 inhabitants)				

<b>60 years and over</b>	<b>348</b>	<b>363</b>	<b>468</b>	<b>747</b>
<b>65 years and over</b>	<b>244</b>	<b>249</b>	<b>322</b>	<b>486</b>
Life expectancy at birth, years				
<b>males</b>	<b>66.4</b>	<b>67.6</b>	<b>71.4</b>	<b>73.8</b>
<b>females</b>	<b>77.2</b>	<b>77.9</b>	<b>79.8</b>	<b>81.1</b>
Number of registered participants in the state funded pension scheme (at the end of the year), thsd <sup>4</sup>				
<b>joined voluntarily</b>	710.5	965.2	1 134.2	919.5
<b>registered obligatory</b>	<b>251.4</b>	<b>331.1</b>	<b>123.1</b>	<b>0.0</b>
	<b>459.0</b>	<b>634.1</b>	<b>1 011.1</b>	<b>919.5</b>
Number of participants in the notional defined contribution pension scheme (socially insured persons), thsd <sup>5</sup>	1 082.7	1 151.9	1 001.4	808.4
Actual retirement age, years				
<b>males</b>	<b>62</b>	<b>62</b>	<b>63</b>	<b>63</b>
<b>females</b>	<b>61</b>	<b>62</b>	<b>63</b>	<b>63</b>
Accumulated reserve / deficit of the state social insurance budget, mln lats	37.5	395.0	797.0	-236.5
Old-age pensions expenditure, mln lats	412.0	443.6	955.4	1 799.8
<b>the state funded pension scheme</b>	<b>0</b>	<b>0</b>	<b>68.8</b>	<b>659.9</b>
<b>the notional defined contribution pension scheme</b>	<b>412.0</b>	<b>443.6</b>	<b>886.6</b>	<b>1 139.9</b>
GDP, at constant prices, mln lats	7 252.1	9 953.3	18 580.1	22 055.8
Old-age pensions expenditure, % of GDP	5.7	4.5	5.2	8.2

Table 11

## Basic assumptions for the projections

Source: calculations by the Ministry of Welfare

	2005	2006	2007	2008	2009	2010	2010-2050
Growth rate of the average monthly gross wages and salaries of the employed in the economy, at constant prices							
<b>baseline</b>	<b>4.1%</b>	<b>5.0%</b>	<b>5.7%</b>	<b>5.7%</b>	<b>6.0%</b>	<b>6.0%</b>	<b>gradually go down to 2% in 2030</b>
<b>baseline + optimistic wage growth</b>	<b>growth of wage is 25% higher than in the baseline</b>						
<b>baseline + pessimistic wage growth</b>	<b>growth of wage is 25% lower than in the baseline</b>						

<sup>4</sup> number of persons who are registered in the state funded pension scheme<sup>5</sup> number of persons for whom social insurance contributions was made in the respective year

Registered unemployment rate (average in year)							<b>gradually decrease from 6,9% to 5% in 2025</b>
<b>baseline</b>	<b>8.5%</b>	<b>8.1%</b>	<b>7.9%</b>	<b>7.7%</b>	<b>7.6%</b>	<b>7.5%</b>	<b>gradually decrease to 5% in 2030</b>
<b>baseline + low unemployment</b>	<b>unemployment rate is 25% higher than in the baseline</b>						
<b>baseline + high unemployment</b>	<b>unemployment rate is 25% lower than in the baseline</b>						
Social insurance contribution rate in the notional defined contribution pension scheme	<b>18.0%</b>	<b>18.0%</b>	<b>16.0%</b>	<b>12.0%</b>	<b>11.0%</b>	<b>10.0%</b>	<b>from 2010 – 10%</b>
Social insurance contribution rate in the state funded pension scheme	<b>2.0%</b>	<b>2.0%</b>	<b>4.0%</b>	<b>8.0%</b>	<b>9.0%</b>	<b>10.0%</b>	<b>from 2010 – 10%</b>
Average profitability in the state funded pension scheme	<b>4.0%</b>						
Life expectancy at birth							
<b>baseline</b>							
<b>males</b>	<b>grow up to 73,8 in 2050</b>						
<b>females</b>	<b>grow up to 81,1 in 2050</b>						
<b>baseline + low mortality</b>							
<b>males</b>	<b>grow up to 80,6 in 2050</b>						
<b>females</b>	<b>grow up to 86,5 in 2050</b>						
Total fertility rate							
<b>baseline</b>	<b>grow up to 1,59 in 2050</b>						
<b>baseline + high fertility</b>	<b>grow up to 2,0 in 2050</b>						
Net migration							
<b>baseline</b>	<b>0 from 2010</b>						
<b>baseline + high immigration</b>	<b>9000 from 2012</b>						
<b>baseline + high emigration</b>	<b>-9000 from 2010</b>						

Notes:

(…) – data not available

(-) – zero

## BACKGROUND STATISTICS FOR COUNTRY SUMMARIES

	LV			EU25				
Adequacy								
Current situation (2002 HBS data)								
	Total	Men	Women	Total	Men	Women		
At-risk-of-poverty rate <sup>1</sup>	16.0	16.0	16.0	...	...	...		
0-64	17.0	18.0	17.0	...	...	...		
65+	10.5	6.1	12.6	...	...	...		
75+	13.0	5.0	15.0	...	...	...		
Income inequality <sup>1</sup>	5.5			...				
0-64	6.0			...				
65+	3.1			...				
Income of people aged 65+ as a ratio of income of people aged 0-64 <sup>1</sup> (%)	82.0	87.0	80.0	...	...	...		
Median pensions relative to median earnings <sup>2</sup>								
<i>excluding other social benefits</i>	0.60	0.67	0.59	...	...	...		
<i>including other social benefits</i>	0.63	0.69	0.61	...	...	...		
Long-term projections								
Pension replacement rates <sup>3</sup>	2010	2030	2050					
Total net replacement rate	77.9	67.1	71.8					
Total gross replacement rate	60.5	51.2	54.5					
Gross repl. rate 1 <sup>st</sup> pillar	60.5	51.2	54.5					
Gross repl. rate 2 <sup>nd</sup> /3 <sup>d</sup> pillar	...	...	...					
Financial sustainability								
Current situation								
ESSPROS Pension expenditure <sup>4</sup> , % of GDP	1995	2000	2002	1995	2000	2002		
	7.0	7.7	6.7	12.8	12.6	12.6		
Employment (2003) <sup>5</sup>	Total	Men	Women	Total	Men	Women		
Employment rate (30-54)	78.3	80.5	76.5	...	...	...		
Employment rate (55-64)	44.1	53.1	38.8	40.2	50.2	30.7		
Effective labour market exit age <sup>6</sup>	60.3	61.6	57.66	61.0 (p)	61.5 (p)	60.5 (p)		
Public finances (2003) <sup>7</sup>								
Public debt, % of GDP		14.4			63.3			
Budget balance, % of GDP		-1.5			-2.8			
Long-term projections (EPC 2005)								
	Level			increase 2010-50	Level			increase 2010-50
	2010	2030	2050		2010	2030	2050	
Old-age dependency ratio <sup>8</sup>	24.9	32.2	48.6	95.2	26.3	40.3	52.8	100.7
Public pensions expenditure, % of GDP <sup>9</sup>	4.5	5.2	8.2	82.2	...	...	...	...
Factors determining the evolution of public pensions expenditure (2000-2050) <sup>9</sup>	Contribution to change in percentage points of GDP				Contribution to change in percentage points of GDP (EU-15)			
<i>Demographic dependency</i>	8.6				6.4			
<i>Employment</i>	-1.5				-1.1			
<i>Eligibility</i>	-1.7				0.6			
<i>Level of benefits</i>	-2.0				-2.8			
<i>Total (including residual)</i>	0.1				3.1			
<b>Notes:</b>								
1. Source: ECHP/EU-SILC, Eurostat, version XXXX. Based on equivalised incomes. Poverty line: 60% of median equivalised income; inequality measure: income share ratio S80/S20.								
2. Source: Eurostat. Median individual pension income of retirees aged 65-74 in relation to median earnings of employed persons aged 50-59 including / excluding social benefits other than pensions. See methodological note.								
3. Source: national calculations according to the method determined by the Indicators Sub-Group of the Social Protection Committee. Theoretical replacement rate of a male worker with a career length of 40 years full-time work at average earnings with contributions to first and second pillar pension schemes, retiring at the age of 65 years. See methodol. note.								
4. Source: ESSPROS, EUROSTAT. Includes expenditure by certain private social protection schemes. <b>Data for EU25 is EU15 data;</b> see methodol. note.								
5. Source: European Labour Force Survey, XXXX.								
6. Calculation method still under discussion.								
7. Source: European Commission, DG ECFIN.								
8. Source: EUROSTAT, demographic projections. Number of people aged 65 and over as a percentage of people aged 15-64.								
9. Source: Economic Policy Committee XXXX. Public pension expenditure (including most public replacement incomes to people aged 55 or over), before taxes. See methodological note.								
<b>Pension expenditure, % of GDP – data for Latvia is from national sources.</b>								
<b>Effective labour market exit age – data for men and women is from national sources.</b>								
<b>In the chapter Long-term projections data for Latvia is from national sources.</b>								
<b>Public pensions expenditure, % of GDP –for Latvia is old- age pensions expenditure data, % of GDP.</b>								
(p) – provisional value								
(...) – data not available								