PENSION POLICY NOTES

OECD
BETTER POLICIES FOR BETTER LIVES

LATVIA

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- **Increase substantially basic and minimum pension levels and index these benefits, both initial levels and in payment, at least at the indexation rate of NDC pensions in payment**

- **Harmonise pension contributions among all workers, including employees of micro-enterprises and the self-employed**

The pension system combines notional defined contribution (NDC) and funded defined contribution (FDC) schemes and covers almost all workers in a largely unified way. The NDC benefit is calculated based on total past contributions uprated with notional interest rates and remaining (period) life expectancy when retiring. The notional interest rate is equal to the growth rate of the wage bill. Hence, changes in both the average wage and total employment affect pension levels. The social security institution collects contributions to individual FDC accounts and administers these accounts while contributors select their private fund managers. As it was introduced in 2001, the FDC scheme is only paying limited pensions yet. The total contribution rate of 20% is split into 14% to NDC and 6% to FDC. To access contributory pensions, including the minimum pension, 15 years of contributions are required, increasing to 20 years in 2025. The minimum pension level increases stepwise for contribution periods between 15 and 40 years, at which point it reaches 11% of the average wage. The old-age safety net consists of the basic pension, which is equal to 6% of the gross average wage and is withdrawn fully against NDC and FDC pensions. Both earnings-related and first-tier pensions can be accessed without penalties at 63 years and 9 months in 2020, increasing gradually to 65 years in 2025. Voluntary pensions play a small role, both in terms of assets and payments.

Key indicators: Latvia and OECD average

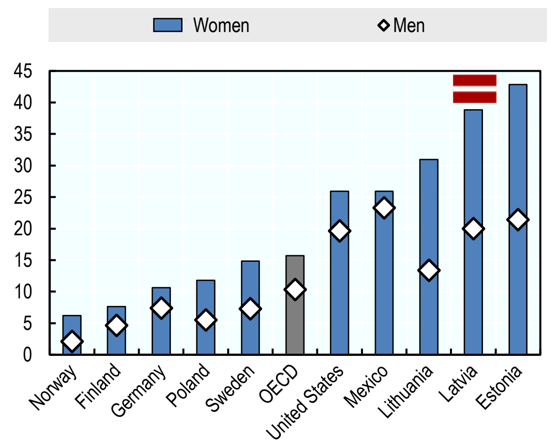
	Mid-1980s	Mid-1990s	Mid-2000s	Latest available	Latest OECD	Long term	Long term OECD
Normal retirement age for a full-time career starting at the age of 22			62 (60.5)	63.8	64.2 (63.5)	65.0	66.1 (65.7)
Statutory retirement age			62 (60.5)	63.8	64.5 (63.8)	65.0	66.5 (66)
Net replacement rate, average earner						54.3 (54.3)	58.6 (57.6)
Effective contribution rate (average earner)				20.0	18.4		
Total pension spending, % of GDP	0.0	0.0	5.6	7.4	10.0		
Public pension spending, % of GDP		0.0	5.6	7.4	8.4		
Public debt, % of GDP		15	15	44	80		
Employment rate 55-64, %			53.5 (44.5)	66.3 (64.7)	68.5 (54.8)		
Labour-market exit age		62.8 (59.9)	64.1 (59.5)	65.7 (64.7)	65.4 (63.7)		
Old-age poverty rate, %				32.7	13.5		
Life expectancy at 65, years	12.4 (15.9)	12.0 (16.4)	12.7 (17.5)	14.2 (19.5)	18.1 (21.3)	19.2 (22.7)	22.5 (25.2)
Old-age to working-age ratio	0.19	0.23	0.28	0.35	0.31	0.54	0.58
Fertility rate	2.2	1.2	1.5	1.7	1.7	1.8	1.7

Note. The figures for women appear in parenthesis where they differ from those for men.
Long term: Around 2060 based on all legislated reforms up to mid-2019.

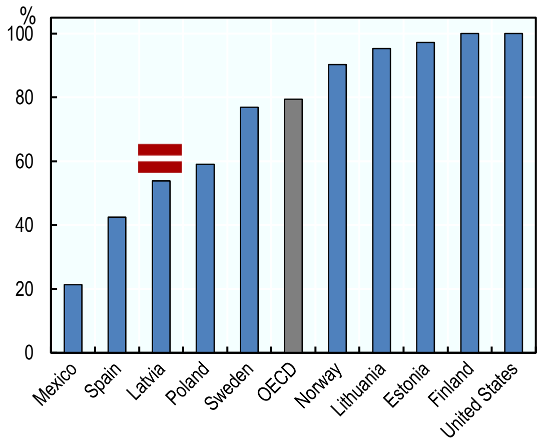
The relative old-age poverty rate is very high. In Latvia in 2016, 39% of women older than 65 years and 20% of men had disposable income lower than half median of the total population's, against OECD averages at 16% and 10%, respectively. The absence of permanent survivor pensions makes surviving spouses, mostly women, especially vulnerable. From 2019, benefits for surviving spouses were introduced at 50% of the deceased's pension, but they are temporary, paid for one year only. Over the last 20 years, the rules for indexing NDC pensions in payment changed frequently and, since 2019, the indexation rate has been set to inflation plus between 50% and 80% of real wage bill growth depending on the individual contribution record. Any indexation applies only to pension amounts that are lower than the ceiling of 120% of average pension in 2018. The first-tier benefit levels are very low (a maximum of 11% of the average gross wage) compared with the OECD average of 20% for non-contributory old-age benefits and of 25% for minimum pensions. During retirement, minimum pensions are indexed in the same way as NDC pensions, but there is no rule to index initial amounts (i.e. at retirement age across generations) of basic and minimum pensions, which levels have been frozen in nominal terms since 2006.

Many workers pay reduced pension contributions, implying reduced entitlements. In 2017, the self-employed and employees of micro-enterprises constituted 12% and 7% of total employment, respectively. Income from royalties, which apply to journalists and writers among others, are subject to a 5% pension contribution rate compared to 20% for employees. From 2018, the self-employed who earn less than the monthly minimum wage also pay 5% in pension contributions compared to paying no pension contributions before. When earning more than the minimum wage, the full 20% pension contribution rate applies up to the minimum wage while income above that is subject to the reduced 5% rate. As a result of the tight link between contributions and benefits, a self-employed worker earning the average wage can expect pension at 54% of that of an employee with similar earnings, against the OECD average of 79%. As for the self-employed who have low turnover (sales), but also firms employing less than six workers and paying low wages, they can choose to pay the so-called micro-enterprise tax instead of corporate taxes on profits, payroll taxes and social security contributions altogether. In 2017, the turnover ceiling, under which eligibility to the regime applies, was drastically lowered. On top, the micro-enterprise tax rate was increased from 12% to 15% of turnover. In addition, the share of receipts from the micro-enterprise tax that finances pension contributions were raised from 70% to 80%. Despite these changes, the micro-enterprise regime most often results in significantly reduced pension contributions.

Relative income poverty rate among people older than 65 in 2016



Future theoretical pensions of the self-employed relative to employees, at average earnings



Source: OECD Pensions at a Glance 2019 (Table 7.2 and Figure 2.13 for left and right panels, respectively).

Increasing first-tier benefits, indexing them - both initial levels and in payment - at least at the indexation rate used for NDC pensions in payment and harmonising pension contributions among all workers would improve pension income prospects. The minimum contribution period for eligibility to old-age pensions of 15 years should be eliminated while on the contrary it is being expanded to 20 years. Pension contributions levied on all earnings - including those from micro-enterprises, self-employment and royalties - should converge. As needed, a part of the contributions could be financed by taxes: if encouraging self-employment is a social policy objective, this should not result in lower pensions and any subsidy should be transparent. In addition, linking retirement ages to life expectancy after 2025 would prevent pensions to decrease in response to increases in longevity.

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