Pensions at a Glance 2019

How does Latvia compare?

27 November 2019

Key findings

- Old-age income poverty is very high. The level of both the old-age safety net and the full minimum pension are very low. Fifteen years of contributions are needed to be eligible to contributory pensions, increasing even to 20 years in 2025.
- The working-age population is expected to shrink by 29% by 2050, four times more than the OECD average while remaining life expectancy at 65 would increase by 3 years while remaining 3 years below the OECD average.
- The legal retirement age will increase from 63 and 9 months in 2020 to 65 years in 2025. In the long-term it will still be below the OECD average that will raise to 66 years around 2060 based on current legislation.
- Automatic links of earnings-related benefits imply a future net pension replacement rate for average-wage workers of 54% at the retirement age against an OECD average of 59%.
- Self-employed workers have much lower income than employees in Latvia. Moreover, even at similar income they often pay very low contributions due to high flexibility in setting the contribution base for regular contributions and explicit rate reductions.
- Many self-employed are likely to have low pensions. For example, paying only the minimum mandatory contributions and having the same taxable income as an average-wage employee will result after a full career in a pension equal to 54% of what the employee will receive, well below the OECD average of 79%.

First-tier benefits have been frozen since 2006

In 2016, people older than 65 in Latvia had low disposable income: 29% lower on average than the total population while it is 13% lower on average in the OECD. This reflects low pension spending, at 6.8% of GDP compared with 9.5% in the OECD. Pension expenditure indeed decreased by 1.8% of GDP over the last two decades with both improvements in financial sustainability driven by the 1996 introduction of the notional defined contribution (NDC) scheme and the slow pension indexation (mostly to prices) while average annual real-wage growth reached almost 5%.

In 2016, 39% of women older than 65 years and 20% of men had disposable income lower than half the median in the total population: these relative poverty rates are at least twice as high as OECD averages. Moreover, since the mid-2000s, the poverty rate increased by 10 percentage points among people older than 65 in Latvia while it decreased slightly for younger age groups.

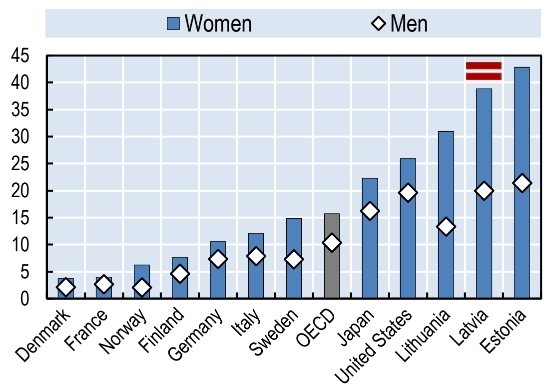
Minimum pensions in payment are indexed in line with old-age pensions. However, both old-age safety-net benefits and the initial (when retiring) level of minimum pensions have not increased in nominal terms since 2006. During the same period, prices increased by 40% and average wages by 119% in nominal terms. As a result by 2018, the non-contributory benefits fell from 13% to 6% of the average wage and the full minimum pension from 24% to 11%. This compares with the OECD average levels of old-age safety nets and minimum pensions (or contribution-based basic pensions, among countries with such a scheme) of 20% and 22% of the average wage, respectively, in 2018.

Over the last two years, indexation rules have been revised in Latvia resulting in moderately higher pensions in general, but substantially higher for those who had long contribution records. In addition, survivor benefits, to which the retired surviving spouses are eligible, were increased from a lump sum equal to twice the monthly deceased's pension to 50% of the deceased's pension for twelve months.

Demographics is likely to weigh heavily on the output of the economy and on its capacity to generate high enough pensions. The working-age population (20-64) is projected to shrink by 29% by 2050 against a 7% decline on average across OECD countries. In 2050, there would be 53 people who are 65 or older per 100 people aged 20-64 in both Latvia and the OECD on average, up from 36 and 31, respectively, in 2020.

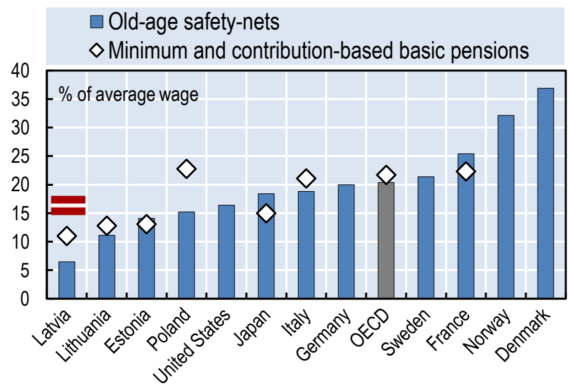
High relative old-age poverty, 2016

Share of population 66+ with disposable income lower than the half of median income for total population



Source: [Table 7.2]

Low first-tier benefits, 2018



Source: [Figure 4.2].

The Latvian NDC system is defined in such a way that the decline in the number of contributors has limited impact on pension finances, but it automatically reduces replacement rates. Likewise, improvements in remaining life expectancy at retirement ages across generations lower pensions (from both NDC and the funded defined-contribution scheme, FDC) all other things equal.

Longer careers are crucial to offset this automatic impact of ageing on benefits. The normal retirement age has been increasing from 62 in 2014 to 63 and 9 months in 2020, and it will reach 65 in 2025. Hence, according to current legislation, it will be below the OECD average of 66 around 2060. Six OECD countries link the retirement age to life expectancy: Denmark, Finland, Estonia, Italy, the Netherlands and Portugal. Financial returns on FDC assets matter also greatly for total benefits as 6 out of the total 20 percentage-point mandatory contribution rate go to FDC. So far, real rates of return in the Latvian FDC have been low, -1.0% per year on average over the last 15 years against +2.3% in the OECD.

Based on OECD projections, assuming in particular identical financial returns in all countries, a full-career average-wage worker entering the labour market at age 22 in 2018 can expect a net replacement rate of 54%, lower than the OECD average of 59%. Moreover, the Latvian pension system includes relatively limited redistributive features. For example, among full-career workers, replacement rates are almost constant across earnings levels while on average in the OECD the net replacement rate for low-wage earners (half average wage) is equal to 68%. The impact of career breaks on pensions is only slightly cushioned in Latvia through pension credits that are granted for up to 9 months of an unemployment spell and for up to 18 months of childcare. In addition, carriers shorter than 15 years, to be increased to 20 years in 2025, result in no pension entitlements from contributory schemes. However, when receiving disability benefits, pension entitlements accrue as if earning half the average wage.

Non-standard forms of work, i.e. other than full-time dependent employment based on open-ended contract, represent more than one-third of total employment in the OECD but substantially less in Latvia. Temporary contracts and part-time work account for 3% and 5% of dependent workers, respectively, compared with OECD averages of 13% and 15%. The incidence of self-employment is equal to 12% of total employment against 15% in the OECD on average. Combining self-employment with dependent employment is more common in Latvia than in many other countries and self-employment represents less than two-thirds of earnings for 62% of people with any income from self-employment in a given year in Latvia against 41% on average across OECD countries.

Non-standard workers have particularly low earnings in Latvia. Temporary and part-time employees have median annual earnings equal to around 40% of the median full-timers while the median full-time self-employed have 70%. These compare to around 50% and 85%, respectively, across European countries with available data.

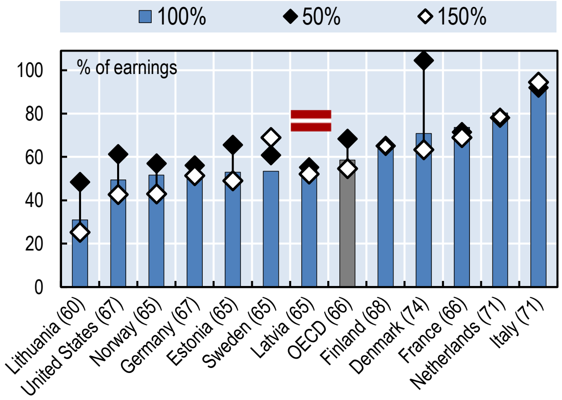
The self-employed in Latvia pay reduced contributions due to both high flexibility in setting the contribution base and explicit rate reductions. If earning more than the minimum wage, the self-employed pay a full pension contribution rate of 20% up to a base that can be chosen freely above the minimum wage and 5% for income above this freely chosen base. Since 2018, self-employed workers who earn less than the monthly minimum wage pay 5% while before they paid no contributions. The same reduced contribution rate of 5% applies also to all income from royalties (e.g. journalists and writers). Furthermore, instead of paying corporate taxes on profits in addition to payroll taxes and social security contributions on earnings, many self-employed can choose to pay the so-called micro-enterprise tax at a reduced rate of 15% on turnover (sales).

Evidence from Poland, Slovenia and Spain shows that a large flexibility granted to the self-employed in setting the contributions base leads to a vast majority of them opting to contribute only the minimum. Overall, there is a large pension coverage gap in Latvia as only around 1% of the total social-security contributions was paid by the self-employed in 2015.

As a result, a full-career self-employed worker having the same taxable income as an average-wage worker but choosing the minimum mandatory contribution base will have a pension equal to 54% of what this worker will receive. By contrast, on average across OECD countries, this ratio is equal to 79%. Furthermore, in Latvia, a journalist receiving royalties equal to the average wage throughout the career will have a pension equal to only 25% of the pension of an employee with similar earnings.

Future replacement rates

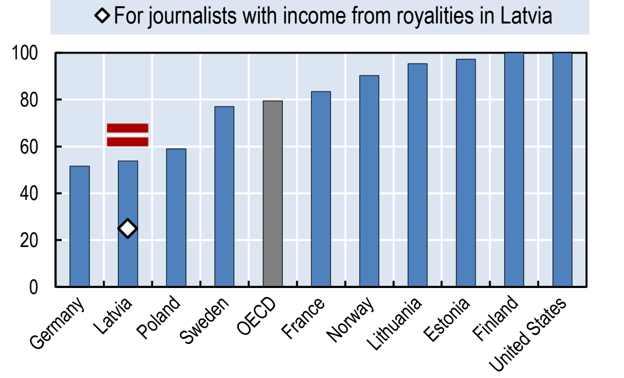
Net replacement rates for full-career workers earning 50%, 100% and 150% of average-wage



Source: [Figure 5.4].

Self-employed workers might receive low pensions

Gross theoretical pensions from mandatory schemes of the self-employed as % of employees, with similar careers and earnings



Source: [Figure 2.13].

Contact: Maciej Lis (+33 1 85 55 45 09; maciej.lis@oecd.org), Hervé Boulhol (+33 1 45 24 84 58 ; herve.boulhol@oecd.org)