Pension policy

Published: 17.08.2020.

Reform of pension system was started in the beginning of nineties. The aim of this reform was to restructure the pension system according to the new socioeconomic circumstances in Latvia.

Latvia was one of the first countries in the Central and Eastern Europe which started the introduction of multi-pillar pension system and the first country in the world which introduced the non-funded generation solidarity pension scheme based on the principles of capital accumulation.

Pension reform was necessary due to various reasons:

- The old system did not comply with the conditions of market economy. Previous pension system did not comply with the new market economy principles and thus it could not function any more.
- People were not interested in paying taxes because the amount of pension did not depend on the amount of contributions. The size of pensions depended on the length of service and the average salary in the state instead of the amount of social insurance contributions. So that the employed could be entitled to receive a pension it was sufficient that employer made contributions according to the minimum salary set in the country.
- The low retirement age and ageing of society. With such demographic situation there would be a lack of means for paying pensions in the future.

There is a three-pillar pension system in Latvia:

- The first - state obligatory non-funded pension scheme;
- The second - state obligatory funded pension scheme;
- The third - private voluntary pension scheme.

It is an insurance system combining the individual personal interest for secured old age with solidarity of generations. The key principle of pension system: the bigger the social insurance contributions today the bigger the pension tomorrow. Simultaneousness of all three pillars ensures the stability of pension system since at every level it squares the probable demographic or financial risk typical of each of these pillars.

The amount of pension in all three levels depends on the contributions therefore those who contribute more or delay retirement to older age gain more income in the retirement age. A common trait is also the fact that in all three levels these contributions are being accumulated (conditionally or directly) by earning the interest and forming pension capital.

In the pension system before the reform the amount of pension depended only on the length of service and the average salary in the state. The accumulation of pension capital was not offered that permits the participant of the scheme to participate in the accumulation of own pension capital, following the target indices of financial capital and especially the performance results of the chosen contribution plan.

Participating in the three pillar scheme one has more opportunities to secure the old age. Since the financial condition of the first pillar scheme is mainly influenced by demographic and labour market factors but funded schemes - by the financial capital market, these levels support one another by mutually squaring out the risks on their way to implementing a common objective - welfare of pensioners.

The 1st pillar of state pension system (state obligatory non-funded pension scheme) is regulated by the Law On State Pensions which came into force on January 1, 1996. This pension scheme is based on social insurance contributions and functions according to the principle of generation solidarity. It means that contributions made by socially insured persons are directed to payment of current pensions. Ideology of pension system intends that the able-bodied population would fully engage in the state social insurance and continue working as long as possible, delaying the retirement to older age.

A following principle is implemented:

larger contribution yields more income,

older retirement age yields even more income.

The 2nd pillar of state pension system (state obligatory funded pension scheme) according to the State Funded Pension Law adopted by Saeima on February 17, 2000, and coming into force on July 1, 2001, is administered by State Social Insurance Agency. The aim of state funded pension scheme is without increasing the rate of social insurance contributions for state old-age pensions (i.e. 20% from the salary) to achieve the increase of pension by investing a part of these contributions into financial capital market where these means would earn the interest.

The second pillar of pension system is compulsory to those who did no reach the age of 30 until July 1, 2001 (was born after July 1, 1971). But those in the age from 30 to 49 (born from July 2, 1951, to July 1, 1971, included) could and still can join this pillar voluntarily. If a person belongs to this age group and has decided to participate in the 2nd pillar or pensions he/she must write an application to the State Social Insurance Agency. In the long run all working population will be involved in the 2nd pillar.

Social insurance contributions of those involved in the 2nd pillar or pensions by mediation of their chosen administrator of means are invested in financial market and accumulated for the pension of certain person.

When joining the 2nd pillar or pensions no additional social insurance contributions must be made. The total amount of contributions for pension capital (20% from the income) remains constant; nevertheless it is divided between the 1st and the 2nd pillar or pensions. In 2012, 2% from the income have been directed to the 2nd pillar, in 2013 and in 2014 - 4%, in 2015 it will make 5%, in 2016 - 6%..

The 3rd level of pension system(private voluntary pension scheme) is effective since July 1, 1998, and it aims at accumulating and investing the personally and voluntarily contributed monetary contributions by mediation of private pension funds, thus ensuring these participants an additional capital in old-age. Pension funds can be closed or open and they can have one or more pension schemes. Participants of pension scheme can participate in pension plan both directly and mediation of their employers. Already from 55 years of age a participant can receive all the accumulated capital or continue the participation and receive capital in parts. Accumulated capital is a property of private person irrespective of the entity who made the contributions; moreover it is subjected to inheritance rights. Alleviations of income taxes and social insurance contributions are also determined.

https://www.lm.gov.lv/en/pension-policy