



# Latvia: the sustainability of “service pensions” scrutinised by the State Audit Office

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## Description

*The sustainability of “service pensions” in Latvia has been called into question by the country’s State Audit Office. The scheme’s coverage has been extended considerably over the past two decades with strong political support, and there has never been a comprehensive assessment of which professional groups should be included into the scheme. Eligibility criteria and calculation procedures vary among professional groups that have access to this scheme. It is important to remedy the deficiencies detected even if this will represent a major policy challenge.*

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In spring 2017, the State Audit Office finalised the audit of the sustainability of the Latvian pension system. In general, it assessed the system as stable but with room for improvement. However, its assessment of the “service pension” scheme was quite critical: the scheme is not in line with the overall Latvian pension policy.

In the general old-age pension scheme, Latvia uses the “notional defined-contribution” (NDC) system meaning that the pension amount received by people depends on the contributions they made during their working career. By contrast, service pensions are a defined-benefit scheme – they are calculated as a certain fraction of the last salary and do not take into account the accrued notional capital. Another difference is that eligibility for service pensions depends on the years served in certain professions, and not on the person’s age; people start to receive this benefit much earlier than the statutory pensionable age. There are situations where people may receive service pension while still being in employment. When a person receiving a service pension reaches the statutory pensionable age, their pension is recalculated in accordance with the general NDC formula. Should the general formula produce a figure lower than the service pension the person was already receiving (which is the case for the majority of service pensioners: on average, the service pension is 1.51 times higher than the state old-age

pension [for example, on average the service pension of diplomats is EUR 1,552 as opposed to EUR 592 for the state old-age pension they are entitled to]), they continue to receive the higher amount.

Until the person reaches statutory pensionable age, the service pension is paid from the general budget (from the funds of the respective Ministry). After reaching statutory pensionable age, the part of the pension equal to the NDC-calculated amount is paid from the social insurance (pension) budget and the surplus from the general state budget.

The State Audit Office states that further promotion of new draft laws widening the range of persons receiving service pensions should not be permitted until a comprehensive systematic assessment of service pensions has taken place.

Originally, the service pension scheme was geared to people employed in occupations associated with early loss of professional skills or abilities, such as firemen or people working in the army, navy police, etc. In 1997, the government decided to make no further extensions of the service pension to new employment categories: thus only military staff and certain officers in the Ministry of the Interior had access to service pensions.

However, during the past two decades (1998-2016) the service pension has been extended to other public sector

employees: to public prosecutors (in 1999), to members of the Constitution Protection Bureau (2003), to performing actors and musicians of state and municipal establishments (2004), to judges (2006), to diplomats (2007), to members of the Corruption Prevention and Combating Bureau (2008), to State security institutions (2015), and to ambulance doctors and drivers (2016). These various categories are regulated by more than 10 different laws. As service pension schemes cover quite influential groups, in some cases the proposed drafts were tabled unexpectedly - just before the third and final reading.

With new categories of people obtaining service pension rights, the scope of this benefit expanded. The service pension is perceived as a fully-fledged social guarantee when reaching retirement age – it is a guarantee for the fact that the employee has been loyal to the state, it is a deferred pay for flawless service and it is a kind of low salary solution provided before the statutory pensionable age.

As a result of this gradual extension of scope, the financing necessary for disbursement of these pensions has grown significantly. In 2011, disbursement of service pensions required EUR 45 million, which represents around 3% of total pension budget; in 2021, EUR 75 million will be necessary (State Audit Office Report, p.102). By comparison, the State Audit estimates (calculation for 2015) that EUR 29.8 million (or 1.86% of total pension budget) would be necessary to increase the amount of minimal pension from 9-13% to 20% of average gross wage. One of the main reasons for introducing the service pension scheme was that the persons receiving it were not able to continue working. However, the data analysis performed by the State Audit Office shows that 7 out of 10 recipients of

service pensions continue working. Moreover, most of them work in institutions or professions similar to those from which they have retired. This means, in practice, that many persons have not even needed to retrain, and the service pension merely provides additional income.

The expansion of service pension rights continues (the service pension bill for the State Probation Service is currently on the agenda of parliamentary commissions) and the employees of the municipal police and some education representatives are actively struggling for entitlement to this benefit.

On 7 June 2017, the State Audit Office informed the Joint meeting of the Committee of Social and Labour Affairs and Public Expenditure and the Audit Committee about the findings of its audit, and invited them to seek solutions to remedy the deficiencies detected.

## Outlook & commentary

The criteria for granting the service pension have not changed since these regulations were initiated for specific employment categories; the service pension was even excluded from the various reforms that raised the statutory pensionable age. Thus, some categories of employees are able not only to retire at a much earlier than the standard pensionable age (38-55 versus 63 in 2017), but the state pays a top-up to their old-age pension from its budget, providing a very generous income replacement in old age. The Ministry of Welfare has not enough political support to stop expansion of the service pension and clarify the goals of this benefit. Many powerful bodies (e.g. the Corruption Prevention and Combating Bureau, public prosecutors, etc.) have turned directly to parliament (without any

discussion in government), successfully using political lobbying to receive the desired status of service pensioners for their employees.

When granting service pensions, there has been insufficient attention paid to ensuring equal treatment not only towards other working people, but also towards the recipients of service pensions themselves. Since the system has been formed over time with strong political support, various criteria and calculation procedures exist for granting service pensions. Without a political decision it will be impossible to solve these problems.

### Further reading

State Audit Office, "Vai valsts politika pensiju sistēmas ilgtspējas nodrošināšanai ir efektīva?" ["Is the state policy for ensuring the sustainability of the pension system effective?"], Rīga, 2017:

<http://www.lrvk.gov.lv/en/latvian-pension-system-assessed-state-audit-office-stable-yet-improvable/>

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