



# A recent reform of the inheritance component may increase trust in the Latvian pension system

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*Before the 2018 national elections, the former Parliament approved amendments to the Law on State Pensions and the Law on State Funded Pensions, introducing partial transfer of pension benefits to widow(er)s and an opportunity to inherit pension accruals. These measures are intended to provide temporary support for widow(er)s and to create incentives for transparent tax and contribution payments, by increasing trust in the pension system. However, they are unlikely to sufficiently improve the adequacy of pensions.*

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## Description

Latvia's public pension system consists of two main pillars: a statutory pension scheme (the "pay-as-you-go" [PAYG] scheme [Notional Defined Contribution, NDC]) and a statutory mandatory funded pension scheme. In 2018, both pillars were amended to include possibilities for partial inheritance of pension benefits (under the PAYG scheme) and pension rights (under the mandatory privately managed pension funds). Until 1 January 2019, Latvia was the only EU Member State in which widow(er)s did not inherit any share of the deceased spouse's pension benefits, whereas so-called "survivor's pensions" were – and still are – only paid to children or other minor dependents of the deceased until the age of 18. Similarly, "Latvia is the only country in the EU, which provides pension capital inheritance only in one form – as pensions in case of loss of supporter, where the range of beneficiaries is very narrow." (Bulle et al. 2018, p. 86).

At the suggestion of MP Andrejs Klementjevs (Social Democratic Party "Harmony"), in April 2018, the Parliament adopted a proposal for a new "allowance for the deceased's spouse", which is paid for 12 months to the surviving spouse (most often, the wife), and which amounts to half of the deceased person's pension. The benefit is only paid if, at the time of death, both spouses were pensioners. If a person dies before retiring, no payments are made to the surviving spouse from the accrued notional capital (i.e. the first

pillar [NDC]). The amendment to the Law on State Pensions came into force on 1 January 2019.

The second pillar consists of private pension funds financed from mandatory social insurance contributions: in this case, unlike under the PAYG scheme, there are some possibilities for inheriting a second pillar pension. When retiring and converting the accrued pension capital into a pension, it is possible to take out a life insurance policy with inherited benefits (at the cost of reducing one's own pension), under certain conditions. Similarly to the first pillar, if a person dies before retiring, no payments to the surviving spouse or other heirs are made from the accrued capital, and the amount is returned from the mandatory funded pension funds to the PAYG "common pool".

In October 2017, a startup pension fund, "Indexo", launched a public sign-in initiative through an online platform to gather signatories in support of making pension accumulations in the second pillar inheritable. In less than three months, a sufficient number of signatures were gathered, and in January 2018 the initiative was passed to the Parliament. In October 2018, the respective amendment to the Law on State Funded Pensions was approved and will come into force from 2020. The default option will remain as present (i.e. a refund to the PAYG), but, at the request of the testator, it will also be possible to include the accrued pension

capital in the succession or to add it to another person's second pillar accruals.

## Outlook & commentary

While the issue of "widow(er)'s pensions" had emerged from time to time in public discussions, these initiatives did not result in any legislative changes until April 2018. Similarly, although various experts, for more than 10 years (see for example Volskis 2008, Rajevska 2016, Arefjevs and Martinovs in LZA 2017), have been stressing the need to make pension accruals inheritable, the successive governments have resisted such initiatives. The "breakthrough" of 2018 can partly be attributed to the election campaign, since parliamentary parties were seeking measures that would please their electorate. More importantly, however, the stalled introduction of the minimum income, against the background of an extremely high percentage of pensioners at risk of poverty, particularly single female pensioners, made the legislators more open to other proposals to improve the situation. In 2017, the at-risk-of-poverty rate for persons aged 65 or above was 39.9% (vs. 15% for the EU-28 average): 29.1% for men and 45.1% for women. In 2018, these rates went up to 37.5% for men and 49.8% for women (provisional data of the Central Statistical Bureau of Latvia). The at-risk-of-poverty rate for single persons aged 65 or above was 72.8% in 2017 (EU-28:22.9%): 68.7% (EU-28: 17.9%) for men and 73.8% for women (EU-28: 25.0%) (Eurostat).

The effectiveness of widow(er)s benefits in reducing the poverty risk among single older women seems, however, rather limited. Preliminary calculations provided in the annotation to the draft bill show that approx. 500 beneficiaries will receive an additional benefit of €156.80 per month on average, which is too small an amount for radical improvement. Given the highly skewed distribution of pension

benefits in Latvia, it is expected that the median benefit amount will be even lower, and the vast majority of these 500 people will get less, while the major "winners" will be in the upper income quintiles.

Where the reform may bring significant benefits, is in increasing the trust of members in the pension system, as well as their willingness to pay the social contributions owed. Under-declaration of wages (when only part of the wage is paid officially with social contributions and income tax assignments, while the balance is paid in hard cash, bypassing taxes) is an acute problem in Latvia: according to estimations from the State Revenue Service, in 2017 the social contributions and personal income tax actually collected were 13.8% short due to under-declared wages. Since the public pension system provides benefits below the poverty line to a substantial share of pensioners, people are discouraged from paying taxes. Men are even more discouraged, as they often believe that they will not live to retirement age (average male life expectancy in Latvia in 2017 was 69.8 for men and 79.6 for women, i.e. 10 years less). The ability to bequeath pension or pension accruals to widow(er)s or other heirs is expected to serve as a strong motivating factor to reduce the shadow economy. According to estimations from the Finance Latvia Association, even a 1% increase in declared social contributions would fully cover (and exceed) the losses that the PAYG budget would sustain due to transfers of second pension pillar capital to widow(er)s or other heirs. Both the pension experts' council (Latvian Academy of Sciences) and a survey of the general public (Bulle et al, 2018) agree that new possibilities for inheritance would reduce the under-declaration of wages, create incentives to pay social contributions and provide motivation to monitor the profitability of pension funds, as well as improving the overall trust in the pension system.

The new government, in place since 23 January 2019, has declared its intention to work further on improving the system of inheritance of pensions.

## Further reading

Bulle, L., Leitane, L. and Rozite, K. (2018), Assessment of funded pension capital inheritance opportunity in Latvia. In: "New Challenges of Economic and Business Development – 2018". Proceedings of the Conference. Riga, University of Latvia, 2018, pp. 79-88: [https://www.bvef.lu.lv/fileadmin/user\\_upload/lu\\_portal/projekti/bvef/konferences/evf\\_conf2018/Proceedings\\_2018.pdf](https://www.bvef.lu.lv/fileadmin/user_upload/lu_portal/projekti/bvef/konferences/evf_conf2018/Proceedings_2018.pdf)

Finance Latvia Association (2018), Par fondēto pensiju shēmā uzkrātā kapitāla mantošanu [The inheritance of capital accumulated in the funded pension scheme]: [https://www.financelatvia.eu/wp-content/uploads/2018/01/5\\_1.23.5e\\_VFPS.pdf](https://www.financelatvia.eu/wp-content/uploads/2018/01/5_1.23.5e_VFPS.pdf)

Latvian Academy of Sciences (LZA) (2017), LZA Humanitāro un sociālo zinātņu nodaļas ekspertu konsīlija "Mana pensija nākotnē" slēdziens" [Conclusion of the LAS Humanitarian and Social Sciences Division Expert Council "My Pension in the Future"]: [http://www.lza.lv/images/stories/noda\\_las/LZA\\_HSNZ\\_konsilija\\_slodziens\\_Mana\\_pensija.pdf](http://www.lza.lv/images/stories/noda_las/LZA_HSNZ_konsilija_slodziens_Mana_pensija.pdf)

Par mantojamu 2. pensiju līmeņa uzkrājumu [Information on the online public sign-in and further development of the legislation initiative]: <https://manabalss.lv/par-mantojamu-2-pensiju-limena-uzkrajumu/show>

Rajevska, O. (2016), Adequacy and Equity of Pensions as a Function of Pension System Institutional Design: a Case of the Baltic States (PhD Thesis): <https://dSPACE.lu.lv/dSPACE/handle/7/31853>

Vojskis, E. (2008), Pensiju sistēmas pilnveidošanas problēmas Latvijā [Pension System's Development Problems in Latvia] (PhD Thesis): <https://dSPACE.lu.lv/dSPACE/handle/7/5180>

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