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Lithuania moves further towards a universal first-tier pension scheme

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Lithuania is changing the mode of calculating the amount of a statutory pension benefit. First, the "general" (basic) component of the pension benefit will become less dependent on the period of past contributions. Second, the "individual" earnings-related component will be subject to a supplementary indexation. By implementing this reform, the Government aims to reduce the at-risk-of-poverty rate among the elderly. However, this reduction will be negligible unless pension funding is further increased.

Description

The Government of Lithuania is reforming the statutory pension benefit formula with the aim of reducing the at-risk-of-poverty (AROP) rate among elderly people. The statutory pension benefit consists of two components: a) the "general" (basic) component, based only on the contributory period and financed from the State budget; and b) the "individual" (supplementary) component, which is earnings-related and is financed from the State Social Insurance Fund (SSIF) on the basis of social insurance contributions.

Up until 31 December 2021, the minimum contributory period required to qualify for an old-age pension benefit was 15 years, whereas the period required for a full "general" flat-rate component was 32 years. The "general" component was subject to a proportional reduction or increase for each year of contribution between 15 and 32 years or above 32 years. The amount of the full "general" pension component was €198.29 per month in 2021, while the average monthly old-age pension benefit for people with the minimum required contributory period of 15 years was only €230 per month and €440 per month for those with the full required period of 32 years. By way of comparison, the AROP poverty threshold for a single person was €430 according to the latest estimates for 2020. Since 1 January 2022, all beneficiaries of the statutory pension scheme have received the full "general" component, even if they have not completed the full contributory period of 32 years. The new measure is expected to have a positive impact on about 11% of all pensioners. Two-thirds of them are women, who usually have a shorter career. The amount of the "general" component will still be higher if the contributory period exceeds 32 years.

Up until 31 December 2021, indexation of both pension components ("general" and "individual") was based on average increases in the total wage bill in the economy for the past three years, the current year, and three forecasted years. Since 1 January 2022, the "general" component continues to be indexed on this basis, but the "individual" component is additionally indexed if the AROP rate of persons aged 65+ is higher than 25% (it has varied between 31.6% and 37.7% between 2017 and 2020 [versus 14.7-17.3% for the EU-27 average]), and/or the projected ratio of the average old-age pension to the average net wage is less than 50%. The index is now calculated in such a way that additional funds for indexing do not exceed 75% of the planned SSIF budget surplus. Thus, three indicators are now crucial to defining the percentage increase of the supplementary indexation: the AROP rate of elderly people, the replacement rate of pensions, and the budgetary capacity of the SSIF.

Outlook and commentary

According to an Explanatory Note from the Ministry of Social Security and Labour (MoSSL) to the Parliament, the main argument for the introduction of this pension reform is the high AROP rate of elderly people and the fact that the average old-age pension is below the AROP threshold. However, the reform may have little impact on the AROP rate for elderly people (i.e. reducing it by around 2 percentage points according to the Explanatory Note).

Indeed, although the "general" component is moving towards universal coverage and towards a flat rate in terms of amount, it still remains too low as a minimum income guarantee instrument (€180.95 per month in 2020, i.e. covering only 70.4% of the official Amount of Minimum Consumption Needs in 2020 [MoSSL, 2021] and 42.1% of the AROP threshold for a single person in 2020). The "general" component was also only slightly higher than the level of the social assistance pension (€140 per month in 2020), which is paid from the general revenue for those not eligible for the statutory social insurance pension. (We provide the 2020 figures because these are the most recent data available for the AROP threshold; in 2022, the "general" component remains very low, at €215.09.)

At the same time, the supplementary indexation of the "individual" component will be more beneficial for pensioners already having an income above this threshold, i.e. the proportional increase of the "individual" component due to indexation will be more beneficial in absolute terms for those with higher pensions.

Nevertheless, a significant outcome of this reform is the continuing transformation of the single Bismarkian statutory earnings-related pension scheme with a record-related component into two separate pension schemes. The first of them is coming closer to a national flat-rate pension scheme financed from the State budget. Its aim is to guarantee a minimum income for older people. The second one, a contributory earnings-related pension scheme, would be free from any vertical redistribution of income; its purpose is income smoothing over the individual's life cycle.

Financing of the "general" component was shifted from the SSIF to the State budget in January 2019. The intention was to fund this component from a broader basis, not only from contributions of people at work. However, the question was then why the benefit amount was still linked to the length of the contributory period? Therefore, the reduced dependency of the "general" pension component on the contributory period as from 1 January 2022 may be seen as the second step towards a universal pension scheme.

Similarly, the supplementary indexation of the "individual" component of the pension benefit is a further step towards a reduction in income redistribution: it will have a more substantial impact on those receiving higher pensions, for whom the "individual" component represents a higher share of their statutory pension. The first step was in 2019 when a ceiling was introduced on social insurance contributions. Still, the "individual" component is too low to compensate for lost income in old age.

To sum up, the two elements of the reform demonstrate attempts to redefine the "general" and "individual" components of the statutory pension scheme in Lithuania. These components may be transformed into two separate pension schemes, each with its own function. However, the effectiveness of each of them will depend strongly on the adequacy of their funding. In the fourth quarter of 2021, the replacement rate of the full pension benefit (€413, i.e. €198.29 for the "general" component plus €214.71 for the "individual" component [Source: Teisės aktų gidas, 2022]) in relation to the average net wage (€1058.6 [Source: Lithuanian Statistics, 2022]) was only 39%. Decisions on increasing pension funding are still awaited.

Further reading

Explanatory note on the Draft Law amending Articles 2, 8, 17, 29, 33, 45, and 49 of Law of the Republic of Lithuania No. I-549 on Social Insurance Pensions, the Draft Law amending Articles 2, 3, 5, and 8 of Law the Republic of Lithuania No. XIV-352 on Single Person Benefit and the Draft Law amending Article 739 of the Code of Civil Procedure of the Republic of Lithuania [in Lithuanian (LT)]

Law of the Republic of Lithuania amending Articles 2, 8, 17, 29, 33, 45 and 49 of Law No. I-549 on Social Insurance Pensions [in LT]

Lithuanian Statistics (2022)

MoSSL (2021): Minister of Social Security and Labour of the Republic of Lithuania. Order No. A1-831. Regarding the approval of the size of the minimum consumption needs for 2022. 23 November 2021 [in LT]

Sagaitytė, G. (2021): The Seimas set the final point: the average pension will increase to €465 euros from next year, and up to €489 for those with the required length of service. LRT.lt, BNS [in LT]

Teisės aktų gidas (2022) [in LT]

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