ANALYSIS

LABOUR AND SOCIAL JUSTICE

REALIZING SOCIAL JUSTICE

Latvia's Pension System in Focus

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Stable and resilient democracies depend on welfare systems that meet basic needs, reduce inequality, and ensure income stability throughout a person's life. While the three Baltic welfare states differ notably in their approaches to achieving social justice, their capacity for redistribution remains among the weakest in Europe.

The Latvian pension system reflects these weaknesses and falls short of fulfilling the essential elements of social justice. This is most evident in its inability to mitigate old-age poverty, which disproportionately affects women, worsens with age, and is likely to remain exceptionally high despite recent reform efforts.

To enhance social justice, effective pension reform in Latvia must prioritize reducing the unacceptably high poverty risks faced by the elderly. A promising policy direction is the introduction of a means-tested supplementary benefit scheme, providing support when pensions, post-retirement income, and asset returns are insufficient to cover basic living expenses, including long-term care.

When designing pension reforms, Latvian policymakers should avoid citing the Soviet legacy to diminish their responsibility in shaping post-transition welfare policy. They should also be cautious about adopting 'success stories' from neighboring countries without thoroughly analyzing what achieving social justice specifically requires in Latvia.

FRIEDRICH EBERT STIFTUNG

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INTRODUCTION

"The real challenge lies in ensuring social justice, so that pensions are not only accessible, but also provided at a reasonably adequate level in relation to the person's earnings."[1]

– Evika Siliņa, Minister for Welfare of the Republic of Latvia (Latvijas Televīzija, May 15, 2023).

The **first objective** of this report is to assess the current and future ability of Latvia's old-age pension system to fulfil its key promises of satisfying basic needs, reducing inequality, and safeguarding income stability among the elderly. These ends constitute the three fundamental components of *social justice* a modern democracy is expected to realize through its welfare system. As shown in Table 1, old-age benefits account for the largest share (41%) of Latvia's total welfare spending – much ahead of spending on healthcare (33%) or family benefits (11%). This division of social spending is consistent with that in Lithuania and Estonia, as well as in most other European countries, highlighting the critical importance of the old-age system in delivering social justice. These high stakes offer a first compelling reason for Latvia to pay careful attention to its pension system's effectiveness amidst the impending challenges of falling birth rates, high levels of outward migration, and an ageing population.

Social spending figures tell us not only about the priority governments and their electorates place on the different functions *within* the welfare state, but also about the effort (or 'generosity') *of* the welfare state in delivering social justice. Social spending as a percentage of gross domestic product (GDP) can be used as a simple, though imperfect, proxy for welfare state effort. As illustrated in Figure 1, over the past decade and a half, The Baltic states have spent a largely constant share of less than 20% of their GDP on welfare. This is about ten percentage points below the EU27 average, making the Baltic welfare systems among the leanest in Europe. Seen over this time, the growth rate of the Baltic economies roughly matches the growth rate of social spending, although the latter (expressed in 2010 prices) seems to have uncoupled from GDP growth in recent years, reaching double-digits after the outbreak of the Covid-19 pandemic.[2]

In short, while social spending figures are helpful to understand the size and the organization of welfare states, they cannot adequately inform us about the performance of a welfare system, let alone its old-age pensions branch, with respect to realizing social justice. For such an evaluative assessment, one needs an approach that focuses on the *impact* of the welfare state – the extent to which it has actually brought about the expected results – rather than merely its financial *input*. The connection between the former and the latter is not straightforward: while increasing the level of social spending may be one response to a negative impact assessment, it is not the only option, especially when a poor policy impact is due to inefficiencies at the implementation stage. This impact-focused methodological approach underpins the analysis in this report. It supports the achievement of its **second objective**: to promote policy-oriented learning within Latvia's welfare system in general and within its old-age pension system in particular. By providing an evidence-based evaluation of its impact on social justice, this report seeks to strengthen the policy process's capability to avoid the repetition of past errors and more effectively respond to current challenges.

There is widespread acknowledgement – popular, academic, and political – that three decades after restoring its independence, Latvia's pension system continues to be burdened by the legacy of Soviet occupation and the manyfold transitional issues from the 1990s. While there is little doubt that the dire state of the Latvian economy after 1991, in pair with widespread institutional failure, clientelism, and the enormous cost of converting Soviet-era welfare rights severely

1 "Tas, kas ir izaicinājums, ir sociālais taisnīgums, lai pensijas būtu ne tikai reāli pieejamas, bet lai viņas arī būtu diezgan adekvātā apjomā no tā, kādu cilvēks ir saņēmis savu atalgojumu."

2 However, early social spending estimates for 2022 (not shown in Figure 1) indicate a sharp decline of inflation-adjusted social spending growth, turning negative in all Baltic states.

Table 1
Expenditure on social protection benefits by function, 2021.

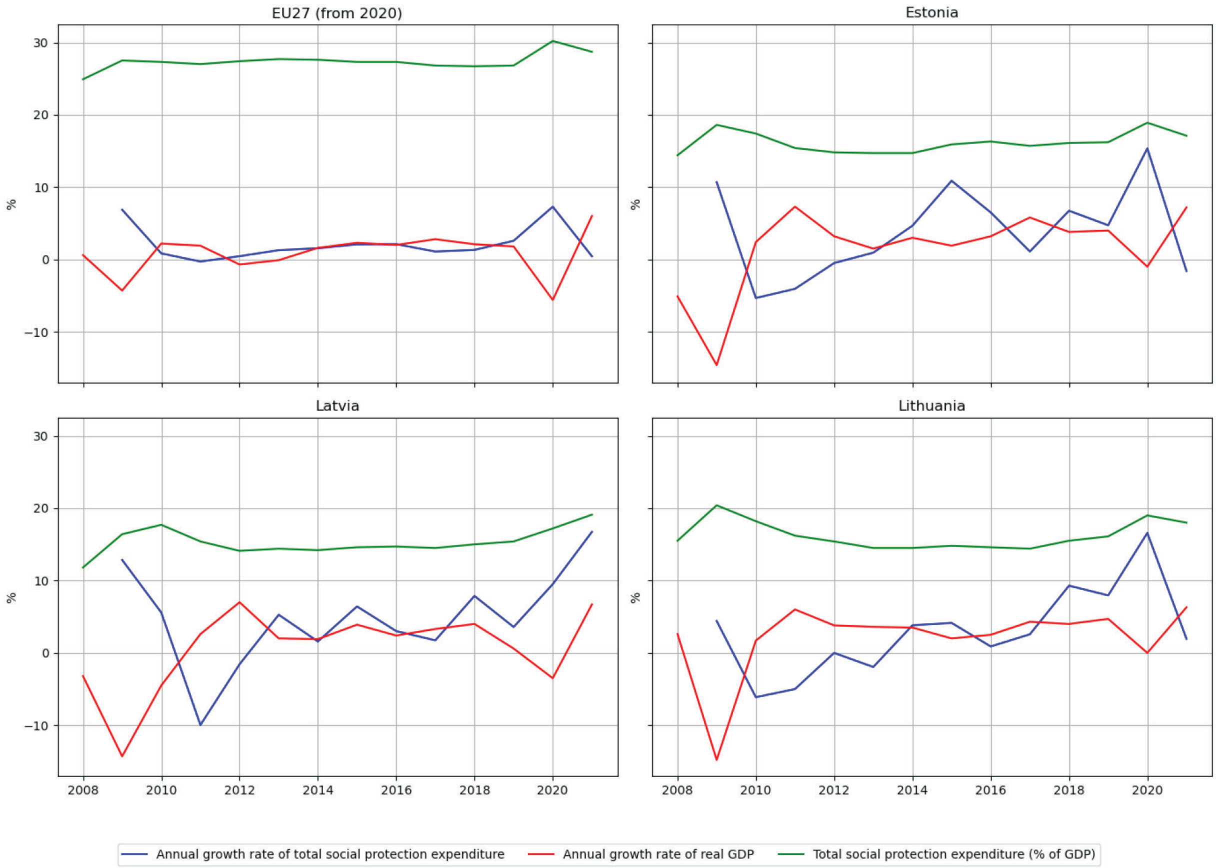
	Old age and survivors		Sickness / health care		Disability		Family / children		Unemployment		Housing and social exclusion	
	% of benefits	% of GDP	% of benefits	% of GDP	% of benefits	% of GDP	% of benefits	% of GDP	% of benefits	% of GDP	% of benefits	% of GDP
EU 27	45.3	13.0	29.7	8.5	6.9	2.0	8.3	2.4	5.9	1.7	3.9	1.1
Albania	53.6	6.9	24.2	3.1	12.4	1.6	6.5	0.8	2.6	0.3	0.7	0.1
Austria	47.8	15.4	27.2	8.8	5.4	1.8	8.5	2.7	9.1	3.0	2.0	0.6
Belgium	45.0	12.9	28.6	8.2	9.2	2.6	7.4	2.1	6.7	1.9	3.2	0.9
Bosnia and Herzegovina	48.2	9.3	35.5	6.8	9.2	1.8	4.0	0.8	2.0	0.4	1.2	0.2
Bulgaria	49.4	9.0	29.2	5.3	8.6	1.6	8.5	1.6	2.8	0.5	1.6	0.3
Croatia	41.9	9.1	35.5	7.7	9.0	2.0	9.1	2.0	2.8	0.6	1.7	0.4
Cyprus	46.0	10.0	27.6	6.0	3.4	0.7	4.7	1.0	11.7	2.5	6.6	1.4
Czechia	44.0	9.3	35.4	7.5	5.7	1.2	8.3	1.8	5.1	1.1	1.5	0.3
Denmark	38.8	11.4	23.5	6.9	16.8	4.9	10.8	3.2	3.9	1.2	6.2	1.8
Estonia	40.6	6.9	29.6	5.1	10.9	1.9	12.8	2.2	5.5	0.9	0.7	0.1
Finland	44.9	13.8	23.2	7.1	9.1	2.8	10.3	3.1	6.5	2.0	6.1	1.9
France	43.1	14.4	30.8	10.3	6.1	2.0	6.7	2.2	7.2	2.4	6.1	2.0
Germany	41.1	12.6	32.7	10.0	7.0	2.2	11.8	3.6	5.1	1.5	2.3	0.7
Greece	62.2	16.6	22.2	6.0	3.9	1.1	5.3	1.4	3.9	1.0	2.5	0.7
Hungary	46.7	8.1	32.2	5.6	5.0	0.9	10.6	1.8	2.3	0.4	3.3	0.6
Iceland	29.4	8.6	33.0	9.6	14.9	4.4	9.7	2.9	8.4	2.5	4.6	1.3
Ireland	30.3	4.0	41.2	5.4	5.0	0.7	8.3	1.1	10.7	1.4	4.5	0.6
Italy	55.9	17.2	22.9	7.1	5.3	1.6	4.1	1.2	6.5	2.0	5.3	1.6
Latvia	41.2	7.8	33.3	6.3	8.0	1.5	11.0	2.1	5.5	1.1	1.0	0.2
Lithuania	38.6	7.0	30.3	5.5	7.8	1.4	11.2	2.0	10.1	1.8	2.1	0.4
Luxembourg	40.1	8.6	26.9	5.8	11.4	2.5	14.8	3.2	4.0	0.9	2.8	0.6
Malta	43.0	7.7	32.7	5.8	3.4	0.6	5.2	0.9	13.4	2.4	2.2	0.4
Montenegro	45.0	8.4	35.7	6.7	7.2	1.3	3.9	0.7	6.2	1.2	1.9	0.4
Netherlands	41.2	11.5	36.0	10.0	8.7	2.4	4.6	1.3	2.7	0.7	6.9	1.9
Norway	37.7	9.9	29.9	7.8	15.8	4.1	10.9	2.9	3.3	0.9	2.5	0.6
Poland	50.8	11.4	25.8	5.8	4.9	1.1	15.0	3.4	1.9	0.4	1.6	0.4
Portugal	53.7	13.7	27.9	7.1	6.8	1.7	5.1	1.3	5.8	1.5	0.9	0.2
Romania	54.9	9.0	26.9	4.4	4.9	0.8	11.9	1.9	0.7	0.1	0.7	0.1
Serbia	52.0	9.9	31.2	6.0	5.0	1.0	6.2	1.2	2.6	0.5	3.0	0.6
Slovakia	44.9	8.5	32.3	6.1	7.4	1.4	10.3	1.9	4.0	0.8	1.1	0.2
Slovenia	43.1	10.7	34.3	8.5	5.0	1.2	7.5	1.9	6.7	1.7	3.4	0.8
Spain	48.0	13.2	29.0	8.0	6.2	1.7	5.6	1.5	9.2	2.5	2.1	0.6
Sweden	44.7	12.2	29.4	8.0	8.9	2.4	10.1	2.8	3.7	1.0	3.3	0.9
Switzerland	45.3	12.6	31.4	8.7	7.9	2.2	5.7	1.6	6.6	1.8	3.2	0.9
Türkiye	57.1	6.1	31.2	3.3	3.1	0.3	4.3	0.5	3.8	0.4	0.6	0.1

Source: Eurostat (online data code: spr_exp_sum).

constrained opportunities for social reform, it is important to avoid totalizing the role of history to the point of downplaying the role of political agency in shaping post-transition welfare policy. As will be shown in Section 3 of this report, there is considerable cross-Baltic variation in certain social justice outcomes, particularly with respect to the evolution of income inequality and income instability. Soviet legacy alone cannot adequately account for such national-level differences. Rather, the evidence suggests that such differences are the result of political choices about the weight of social values, including the core components of social justice. In line with the second objective stated above, this report encourages decision-makers in Latvia to adopt a more proactive, future-oriented role when it comes to shaping the terms of social security in old age.

Finally, this report works on the premise that even in times of great geopolitical uncertainty, promoting social justice is not a luxury, but a fundamental necessity. While macroeconomic challenges and security issues currently dominate the national agenda, it is crucial to remember that the backbone of any democratic society is its commitment to justice. By monitoring and strengthening the capacity of its pension system to track the values of autonomy, equality, and income stability, Latvia ensures that it does not lose sight of the well-being of *all* citizens, particularly the most vulnerable ones. What is more, by protecting the elderly from the risks of poverty and deprivation, Latvia also fortifies itself against the divisive impacts of inequality and political alienation. For these reasons, assessing the pension system from a social justice angle is far more than

Figure 1
Annual growth rates of GDP and total social protection expenditure



Social protection expenditure is measured in constant 2010 prices. It comprises all interventions, in cash or in kind, from public or private bodies intended to relieve households and individuals of the burden of a defined set of risks or needs, provided that there is neither a simultaneous reciprocal nor an individual arrangement involved. Provisional expenditure data: EU27 (2017-2021), Latvia (2019-2021), and Lithuania (since 2020-2021).

Source: Eurostat (online data codes spr_exp_sum, nama_10_gdp).

a theoretical exercise: it is a practical imperative for a prosperous future of Latvia.

The next section offers some historical and theoretical background about the idea that modern nations realize social justice through their welfare system. It also addresses some of the challenges this idea has experienced over the course of the past decades. Section 3 then provides a practical definition of the three key components of social justice – need, equality, and income stability – and applies them as benchmarks for the assessment of welfare state effectiveness in the three Baltic states. On the basis of this broader comparative assessment, Section 4 then zooms in on the Latvian pension system, offering a detailed diagnosis of its performance in the light of the three social justice components. Section 5 summarizes the identified shortcomings and proposes a number of policy pathways in view of future pension system reform.

2

THEORETICAL BACKGROUND: REALIZING SOCIAL JUSTICE THROUGH THE WELFARE STATE

It is tempting to define the welfare state following a famous quip (ascribed to former US Treasury Under Secretary Peter R. Fisher) as a "gigantic insurance company with an army." The significant proportions of social security and health insurance budgets in most advanced states – accounting for more than 50% of all government expenditure in the US and the EU – lend some credibility to this characterization. But the statement also captures what during the twentieth century became one of the most defining features of the modern state: the willingness of the government to provide its citizens with a certain level of protection against risks to their uninterrupted flow of income "from cradle to grave" (Beveridge 1942).

Along with the invention of the welfare state – commonly dated back to the social insurance programs introduced in Imperial Germany during the 1880s (though the term *welfare state* itself emerged only in 1940s Britain) – came the "normalization of risk" (Freeden 2003). Poverty and deprivation, once stigmatized as signs of personal irresponsibility (suggesting a 'weak', 'idle', or 'antisocial' character), came to be seen as arbitrary, random, and indelible possibilities in an unpredictable world. Simply tolerating the humiliating consequences of brute bad luck, according to the new welfare thinking, would be an affront to human dignity. The phrase 'we are all in the same boat' aptly expresses the new sense of solidaristic responsibility which was thought to arise from the shared exposure to risk. Safeguarding citizens against existential harm to their livelihood, on this account, was no longer a matter of compassion or benevolence, but a matter of "social rights" guaranteed by the state (Marshall 1950).

At the turn of the twentieth century, the proliferation of welfare thinking (fueled by the social changes from industrialization, urbanization, and accelerating democratization) opened a window of opportunity for an unprecedented growth of social spending (Lindert 2004) and a surge of social policy innovations across Northern Europe, rapidly spilling over as far as Japan, Australia, and New Zealand (Castles 1985, Kuhnle & Sander 2021). A significant factor in this transnational diffusion of social policy was the founding of the International Labor Organization in 1919 and its push for an expansion of workers' rights in the name of social justice, viewed as essential for achieving "universal and lasting peace" (ILO 2019). Nonetheless, the initial impact of justice-based arguments for the welfare state shouldn't be exaggerated. Early welfare programs were highly selective in terms of risks and population groups covered. Social insurance services were limited to the risks of (male) industrial workers – sickness, accident, and disability, followed (with some delay) by unemployment, and old age – and benefit levels were generally very modest. What is more, social policy pioneers were often less motivated by progressive interpretations of social justice or by expanded definitions of risk than by the logic of power and the need to appease domestic unrest, particularly working-class protest and church-state tensions (Rimlinger 1971; Flora and Alber 1981; Hennock 2007; Manow and van Kersbergen 2009).

The idea of publicly provided social insurance marked a deep shift in the primary function and legitimacy of the state: unlike the early modern state of the seventeenth and eighteenth centuries, which acted as a *protector* against military conquest and political unrest, the welfare state now seeks to secure citizen loyalty as a *provider* of public services essential for the well-being of individuals and families (Ansell and Lindvall 2021). The normalization of risk coincided with a broader normalization of the state, namely by making it a familiar part of people's everyday life. This idea found literal expression in Per-Albin Hansson's vision of turning Sweden into a *folkhemmet* ('people's home'), a safe haven for everybody founded on status equality and mutual respect (Kildal & Kuhnle 2005; Kautto & Kuitto 2021). Hansson, who was the leader of the Swedish Social Democrats since 1925 and served as Prime Minister from 1932 to 1946, thus laid the groundwork for the generous and universalistic social policies widely recognized today as the Scandinavian or social democratic welfare state model (Esping-Andersen 1990).

The view of the welfare state as the principal instrument for realizing social justice became fully established after the shock of the Second World War. On an influential account, the golden age of welfare state expansion (1945-1975) is a consequence of a strengthened sense of solidarity in war-torn societies which helped to free social policy from its class struggle connotations, thus enabling broad cross-partisan support for increased social spending (Goodin 1986; Goodin and Dryzek 1995; Obinger et al. 2018). The key characteristic of the post-1945 welfare state was the departure from selective social insurance schemes towards universal coverage for the entire population. In other words, eligibility criteria for welfare benefits were broadened, and benefit allocation became increasingly uncoupled from individuals' economic standing. This move towards universalism is reflected in the gradual shift in language from 'social insurance' to 'social security'. John Maynard Keynes's "middle way" of welfare capitalism, with the joint objectives of robust economic growth, full employment, and the guarantee of basic social security which markets fail to deliver, became the main paradigm of welfare state expansion for nearly three decades.

To this day, the promotion of universalistic social security under the banner of social justice remains a central project of social democracy and the political left. However, appeals to justice have become commonplace in democratic politics more broadly understood, including among the neoliberal critics of the Keynesian welfare state. Starting from the late 1970s, one prominent argument for rolling back the interventionist 'nanny state' posited that redistribution is unjust in itself, as it involves taking away resources from people (i.e. the wealthy) who rightfully own them (Nozik 1974). Another influential critique of welfare-state redistribution drew on a presumed trade-off between efficiency and equality (Okun 1975). Redistribution, according to this line of thought, is economically wasteful: high taxation, work disincentives, and other inefficiencies of the redistributive system are said to shrink the 'size of the pie' – the total sum of well-being that could be realized within a country – which is a morally questionable outcome. Such views were most prominently at work in Ronald Reagan's (in the United States) and Margaret Thatcher's (in the United Kingdom) attacks against social spending. Though significant pressure for a retrenchment of the welfare state also came from international organizations such as the International Monetary Fund (IMF) or the Organization for Economic Co-operation and Development (OECD). Despite these challenges, empirical evidence shows that social spending in the post-war welfare states has been remarkably resilient, largely resisting these manifold pressures (Pierson 1994).

This doesn't imply that the relationship between welfare policy and social justice has remained unaffected by the neoliberal challenge. Facing the financial strain on existing welfare systems caused by de-industrialization and an ageing population, the twenty-first century has witnessed the birth of a new welfare state paradigm, known in the literature as the 'social investment' approach (Esping-Andersen et al. 2002; Morel et al. 2012; Hemerijck 2017; Garritzmann et al. 2022). Central to this approach is the idea that to achieve the normative goals of the welfare state in post-industrial times – with its distinctive "new social risks" of precarious employment (e.g. being among the working poor, being employed in the shadow economy), difficulties to reconcile work and family life (including childcare), single parenthood, and insufficient social insurance coverage (Taylor-Gooby 2004; Bonoli 2005) – there must be a stronger focus on human capital formation and 'activation' and less emphasis on protecting income flows. In other words, according to the social investment approach, the main mission of the welfare state is to proactively address social risks *ex ante*, before they disrupt income flows, rather than by offering compensation ex post. From a normative point of view, this shift from a redistribution of income towards a redistribution of capabilities and life chances suggests a deemphasis of the need component of the welfare state in favor of enhanced equality of opportunity, especially in the domains of gender inequality and intergenerational transmissions of social disadvantages. Thus, social policy is no longer understood solely as an imperative of human dignity, but also (and perhaps predominantly) as a productive investment into a future of sustainable economic growth, high-skilled labor, low (youth) unemployment, and financially healthy pension systems.

Therefore, it is not surprising that the clearest empirical signs of a shift from compensation to social investment are observed in the increasing rates of spending on education, active labor market policies, and care services for children and the elderly (Garritzmann et al. 2021). However, the speed of this transformation varies strongly across countries. Leading the way in social investment are the Anglo-Saxon countries (specifically Britain, Ireland, New Zealand, and Australia), the Baltic countries (Toots and Lauri, 2022) and the Nordic countries, except for Finland. In the Nordic region, social investment strategies seem to come at the price of a gradual "de-universalization" of the welfare state (van Kersbergen and Kraft 2017), manifested e.g. in tightening eligibility criteria for welfare benefits (especially those targeting the poor and migrants) or the increasing privatization of childcare and education. While this trend unsettles a fundamental pillar of Nordic national identity, it remains to be seen whether the trade-off between social investment and universalism is indeed a general and unavoidable consequence. Further research is needed, especially from lesser-studied areas like the Baltic states, to assess whether social investment strategies undermine social justice, as some critics fear, by benefitting the middle classes at the expense of the most disadvantaged, whose projected 'return on investment' might be considered too low.[3]

3 A phenomenon also known as the 'Matthew effect' (Bonoli et al. 2017, Laruffa 2021).

3

REALIZING SOCIAL JUSTICE IN THE BALTIC STATES

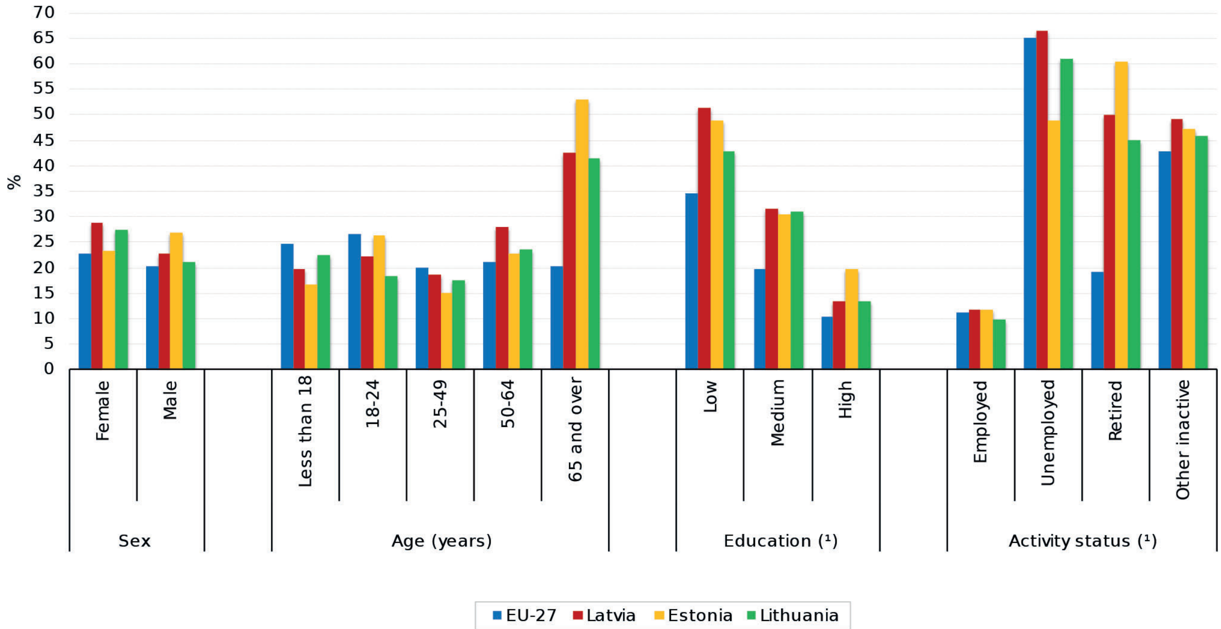
The previous section has portrayed the welfare state as both an integral part of a modern nation-state and an embodiment of certain ideals about a just society. It is now time to define these ideals more precisely, so that they can serve as concrete criteria for evaluating the effectiveness of Latvia's welfare system in realizing social justice. Additionally, this assessment will compare Latvia's performance with that of its Baltic neighbors, Estonia and Lithuania. This comparison is relevant not at least because of their shared historical legacy and the similar socio-economic challenges they faced in reforming social policy after regaining independence in 1991.

Unfortunately, but not unexpectedly, there is no agreement about the exact components of social justice, nor about how to best transform them into testable benchmarks for welfare arrangements. For instance, whether the generous, universalistic Nordic welfare model is "more just" than the liberal Anglo-Saxon model is a matter of how one chooses to identify, interpret, and weight the values that the welfare state should realize. And this choice, of course, is not free from one's ideological and political views about the ideal distribution of benefits and burdens within society. So, to avoid committing to any particular ideological standpoint, we must define the components of social justice as broadly as possible, while still allowing for using them as external standards for the empirical assessment of real existing welfare systems. Accordingly, we can distinguish three fundamental values that underlay all modern conceptions of welfare state and that, we believe, are beyond significant dispute: *need*, *equality*, and *income stability* (Goodin et al. 1999; Miller 1999; White 2021).

3.1 NEED

Welfare states are expected to ensure that every person has access to basic resources needed to lead a minimally decent life in their society. What exactly those basic resources are, to what extent they are of a monetary or a non-monetary kind, and how much they extend beyond what is required for mere

Figure 2
Share of people at risk of poverty or social exclusion, analyzed by socio-economic characteristic, 2022



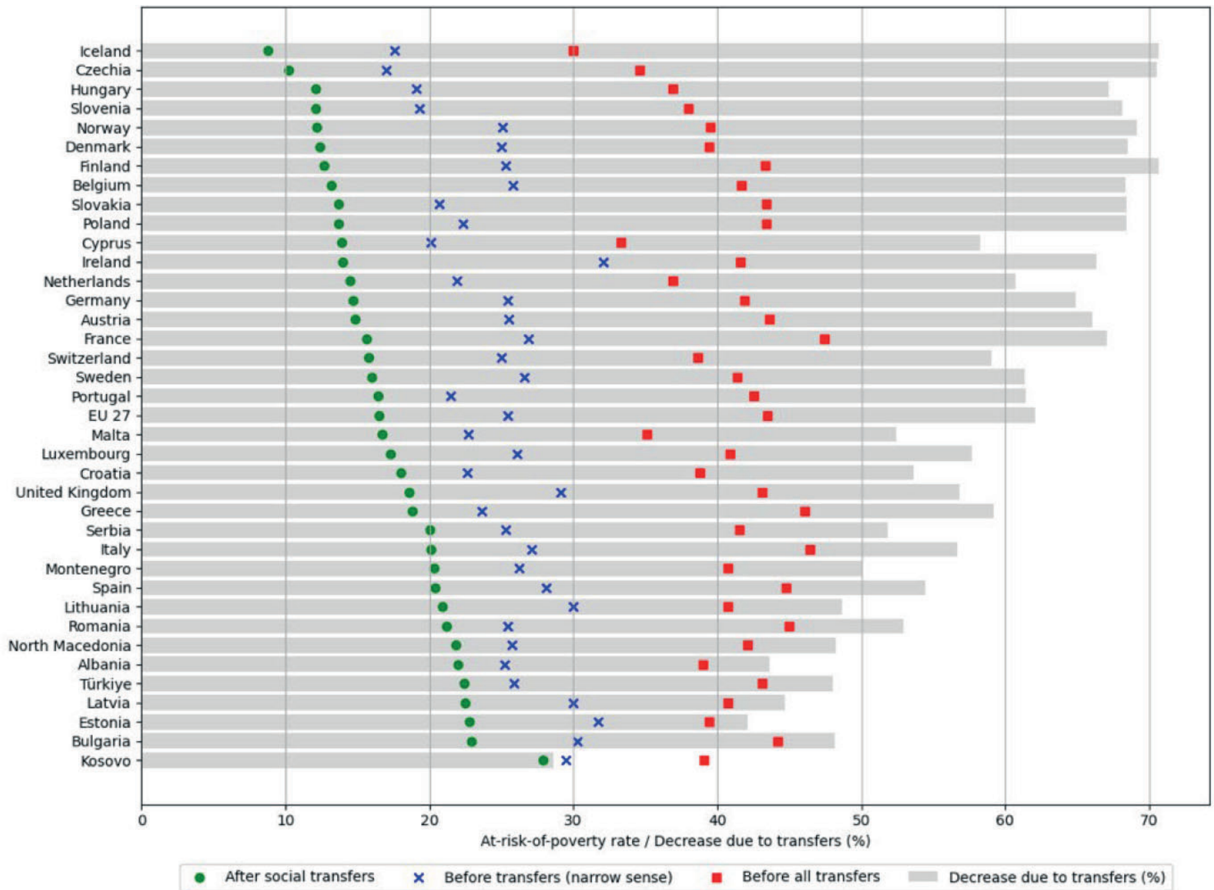
(¹) Population aged 18 and over.
Source: European Union Statistics on Income and Living Conditions (EU-SILC) (online data codes: ilc_peps01n, ilc_peps02n, ilc_peps04n).

physical survival are highly debated philosophical questions (Sen 1987; Sen 1992; Fraser 1989, Nussbaum 1990, Robeyns 2006, Wolff and De-Shalit 2007). Several conceptual innovations and new measurements of basic needs – and the related concept of poverty – have sprung from these debates in the recent decades (Ravaillon 2011; Alkire et al. 2015). A common premise is that basic needs are multidimensional, comprising both monetary and non-monetary resources such as access to basic healthcare, social connectedness, or freedom from discrimination. Likewise, it is widely recognized to define basic needs (and the corresponding satisfaction thresholds) relative to a nation's wealth and income. The European Union's *at risk of poverty or social exclusion* (AROPE) indicator is a well-known application of such a multidimensional conception of need (Eurostat 2021). It is being used to monitor social policy in terms of its effects on the number of persons who are either:

– "at risk of poverty" after social transfers (who have a disposable income below the at-risk-of-poverty threshold set at 60% of the national median disposable income); or
– "severely materially and socially deprived" (persons who cannot afford at least seven out of thirteen deprivation items that are considered by most people to be desirable or even necessary to lead an adequate quality of life); or
– "living in a household with a very low work intensity" (households where adults worked for 20 % or less of their total combined work-time potential during the previous twelve months).

In 2022, the risk of poverty or social exclusion in Latvia and in the Baltic region was greater than in the EU for both women and men, for people at all levels of educational attainment and, most drastically so, for elderly and retired persons (see Figure 2). The share of the retired whose basic needs are not adequately satisfied is more than three times higher in Estonia (60.5%) than in the EU (19.1%). In contrast to the familiar view of Estonia as a flagship for economic and social reform, the country is setting a negative record for old-age poverty, surpassing not just its Baltic neighbors but also all other EU member states. Seen across age groups, poverty and social exclusion in the Baltic states overwhelmingly is a property of the over 65 years old. Again, this contrasts sharply with the general trend in the EU, where these burdens are more evenly distributed across age brackets (and indeed affect the younger than 24 years old more than the elderly). The disproportionate risk of poverty faced by the elderly Baltic population highlights ongoing severe intergenerational inequalities.

Figure 3a
At-risk-of-poverty rate before and after social transfers, total population, 2022



2022 or last available year. The at-risk-of-poverty threshold is set at 60% of the national median equivalized disposable income after social transfers. Social transfers in the narrow sense cover all social transfers excluding pensions and survivors' benefits, which are considered as household income.

Source: European Union Statistics on Income and Living Conditions (EU-SILC) (online data codes: ilc_li02, ilc_li09, ilc_li10).

Although the situation presented here is a contemporary snapshot, it should be reminded that old-age poverty is a consequence of disadvantages individuals had accumulated during their past working lives. High relative levels of poverty and social exclusion in old age therefore indicate not only the unpreparedness of the Baltic welfare system to account for the distinctive vulnerability of old age, but also its failure, and lacking political recognition, to mitigate the transmission of socio-economic disadvantages over a life course.

Figure 3 compares the impact of European welfare systems on basic needs satisfaction for the entire population (Figure 3a) and for the over 65 years old (Figure 3b). For data availability reasons, needs are here measured in purely monetary terms, using Eurostat's at-risk-of-poverty (AROP) rate.[4] While all welfare systems in the sample substantially reduce the 'market' AROP rate – the poverty rate that would prevail in the absence of all social transfers (higher than 40% in most countries for the total population, and higher than 80% for the over 65 years old) – the magnitude of this reduction is subject to significant cross-national variation.

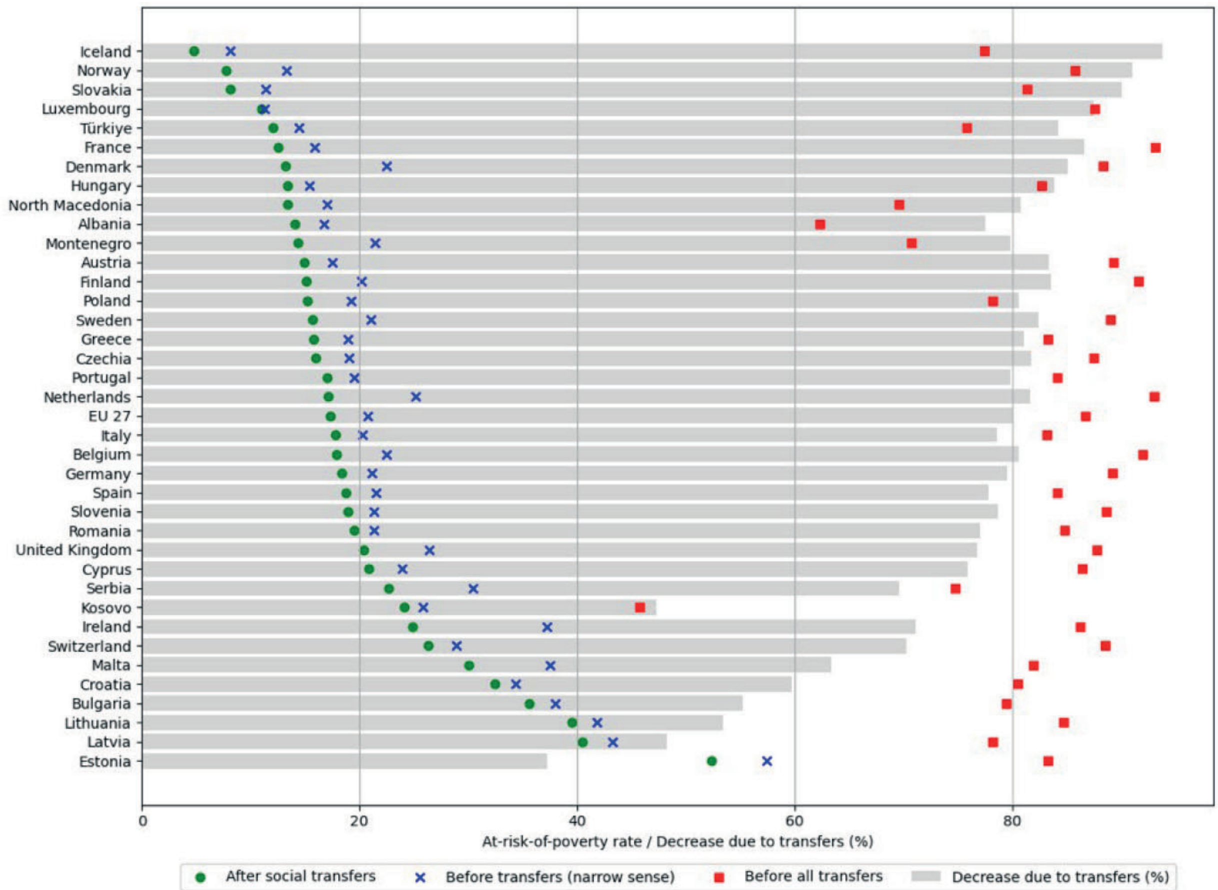
4 The share of the national population with a disposable income (after social transfers) below the at-risk-of-poverty threshold, set at 60% of the national median disposable income.

Gauged by the ability to reduce the 'market' AROP rate, welfare systems in the Nordic countries and in some Visegrád countries lead the way. Iceland, Czechia, and Finland have reduced their AROP rates by over 70% among their total populations, and by over 80% among their elderly populations. At the other end of the spectrum lie the peripheral countries of Eastern Europe, including the Baltic states, whose transfer systems struggle to reduce their 'market' poverty rate by more than 50%. The situation is particularly grim for the Baltic welfare systems in terms of their capacity to reduce poverty among the elderly. Estonia, Latvia, and Lithuania are at the bottom of the European ranking, performing on par with Bulgaria and Kosovo.

3.2 EQUALITY

Securing basic needs is not the only ethical objective of the welfare state. Welfare states also are expected to redistribute resources in order to reduce differences in income and living standards for reasons of fairness. This demand for fairness has different justifications, one being that people value social cohesion (assuming that increasing differences in living standards harm the 'fabric' of their society), and another one being that people value autonomy (assuming that excessive differences in living standards make it difficult for people

Figure 3b
At-risk-of-poverty rate before and after social transfers, elderly population (65 or over), 2022



2022 or last available year. The at-risk-of-poverty threshold is set at 60% of the national median equivalized disposable income after social transfers. Social transfers in the narrow sense cover all social transfers excluding pensions and survivors' benefits, which are considered as household income.

Source: European Union Statistics on Income and Living Conditions (EU-SILC) (online data codes: ilc_li02, ilc_li09, ilc_li10).

to plan their future material circumstances and thus to make long-term projects). Besides that, the promotion of equality is sometimes seen as an end in itself. Like with the definition of basic needs, what the terms of fairness are exactly and how they are to be measured remains disputed. The welfare state literature commonly distinguishes between equality of opportunity and equality of outcome:

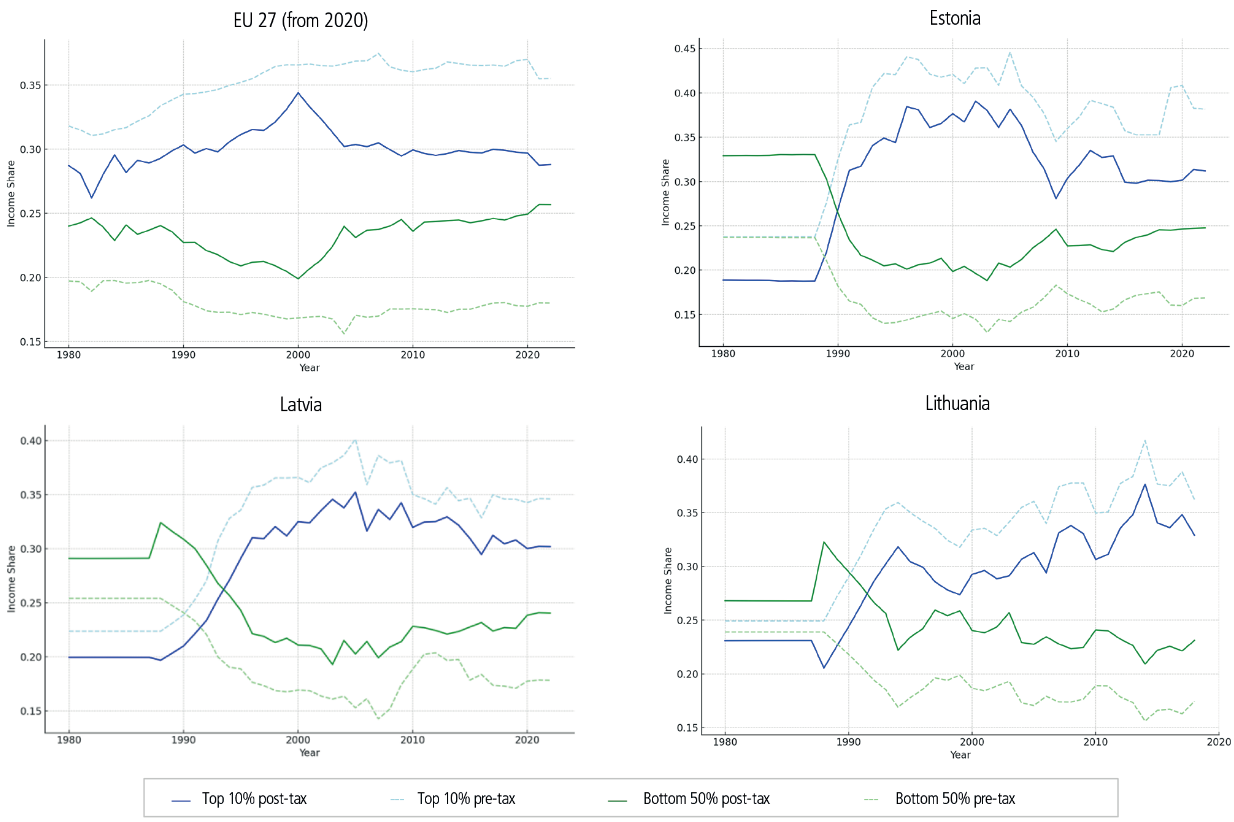
– *Equality of opportunity:* the competition for socially and economically advantageous positions should not depend on circumstances beyond people's control (e.g. sex, skin-color, social class, family structure, etc.). Talent and effort are valid criteria in such a competition, but the development of these virtues shouldn't be predetermined by unchosen background conditions (Cohen 1989; Rawls 1999; Dworkin 2000). Where necessary, the welfare state needs to step in and equalize opportunities for accessing social advantages (for example by increasing investments in public education or by compensating women for disadvantages incurred by an unequal share of caregiving work within households)
– *Equality of outcome:* the income and wealth of people within a society should only vary within a reasonable, socially, economically, and politically accepted, range.

It is generally accepted that the former is less demanding, more in line with the intuition that personal responsibility and merit matter for fairness, and thus more policy-relevant than the latter. Assessing whether welfare systems adequately equalize opportunities, however, is notoriously difficult, and so the analyst has often no choice but to focus on the monetary outcomes ensuing from opportunities and how these outcomes are developing over time (Phillips 2004).

Figure 4 shows how the deep political and economic transformations that have occurred in the Baltic states in the last four decades have affected income inequality. We express inequality by comparing the shares of national income held by the income-rich (adults in the top 10% of the income distribution) and the income-poor (adults in the bottom 50% of the income distribution) both before and after government redistribution through taxes and transfers. Two important patterns bear mention, one pertaining to the *distribution* of income, the other pertaining to the *redistribution* of income through social and fiscal policy.

First, consider the evolution of pre-tax national income shares. Beginning with the *perestroika* in late 1980s, the Baltic states experienced a massive increase of the disparity between the top 10% and the bottom 50% of the income distribution. Clearly, the transition from a Soviet planned economy, which maintained low levels of (outcome) inequality through ensuring full employment and the prohibition of private markets, to an open market economy overwhelming-

Figure 4
Top 10% and bottom 50% income shares before and after redistribution, 1980-2022



Reading example: in 2020, the share of national income held by the 10% income-richest Latvians is almost 35% before accounting for the operation of the redistributive transfer/tax system and 30% after redistribution. Whereas the share of national income held by the 50% income-poorest Latvians is 18% before and 24% after redistribution.
The population is comprised of individuals over age 20. The base unit is the individual (rather than the household) but resources are split equally within couples. Pre-tax national income is market income including cash social insurance benefits net of contributions. Post-tax national income deducts taxes and adds in-kind social benefits, thus reflecting income after considering government redistribution. No data available for Lithuania after 2019.

Source: World Inequality Database (WID.world).

ly worked to the benefit of the top 10% while involving a collapse of the national income shares owned by the bottom 50%. A fact that can be explained with the dynamics of deindustrialization, a rapid liberalization of capital markets, and a frequently clientelistic privatization of state assets. While a widening pre-tax income gap was during the 1990s also observed in Europe as a whole, as shown in the top-left panel for the EU 27, it is likely that this trend was driven to an important extent by the post-transition dynamics in Eastern Europe. Notably, the path towards high levels of income inequality unfolded differently among the Baltic countries. Estonia, which moved on faster than the other Baltic countries with privatization and the development of its commercial banking sector (Masso et al. 2014), experienced the swiftest and most substantial increase in income inequality. By the mid-1990s, the difference in national income shares held by the 10% richest and the 50% poorest Estonians amounted to nearly 30 percentage points. In contrast, post-transition inequality was considerably lower in Latvia and the lowest in Lithuania, reflecting its comparatively slower pace of privatization and deindustrialization. Remarkably, the global economic crisis of 2008 initiated a decreasing trend in pre-tax wage inequality in Estonia and to some lesser extent also in Latvia. This is in stark contrast to Lithuania, where income disparities began to widen significantly thereafter.

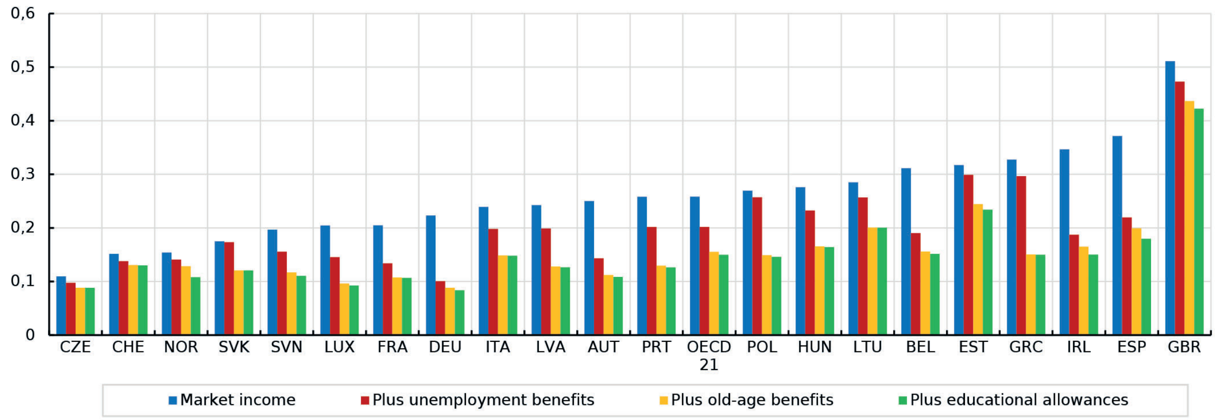
Second, consider the impact of government redistribution on income inequality. Since the 1990s, the welfare systems of all three Baltic countries have managed to narrow the income gap by taxing the top 10% and by providing benefits to the bottom 50%. However, only Latvia and Estonia have significantly reduced income inequality over time. By 2022, the income share held by the richest 10% in these countries was only about 6 percentage points higher than that of the poorest 50%, aligning with the average redistributive impact across the EU 27. In contrast, Lithuania shows no such trend, indicating a weaker redistributive capacity of its welfare system. Despite benefits from redistribution, the share of national income for the bottom 50% in all three countries has stagnated below 25% since around 2010, much below the share they used to hold before 1991. This observation raises concern regardless of the emphasis one places on income as a metrics for social equality. It indicates ongoing issues not only with the redistributive system as such but also, and perhaps more alarmingly, with the lack of equal opportunities hindering upward mobility for a significant portion of the Baltic population.

3.3 INCOME STABILITY

The third fundamental ethical objective of the welfare state is social stability, with *income stability over a life course* being its most critical aspect. Almost everyone experiences income fluctuations over the course of their lives. Many of these changes are due to foreseen 'life events', such as leaving home in early adulthood, reducing work hours to care for children, or reaching retirement age. Some life events (such as the birth of a child) may increase individual well-being even if they entail a lower disposable income. However, negative income changes due to unforeseen events, such as household breakdown (e.g. due to divorce), job loss, or involuntary reductions of working hours often lead to existential stress and suffering. In the long run, unmitigated income instability is known to exacerbate poverty and health risks (Wolf and Morrisey 2017) and to create unequal opportunities, including for children (OECD 2023a). What is more, involuntary income fluctuations restrict personal autonomy by impacting one's ability to self-develop and plan for the future.

In summary: fluctuating incomes and the resulting economic insecurity can hinder the realization of other social justice principles, including basic needs satisfaction and equality discussed above. In recognition of the linkage between these core principles of social justice, the modern welfare seeks to

Figure 5
Income instability before and after social transfers, averaged over 48 months ending 2016-2018



Income instability is measured by the average squared coefficient of variation of monthly equivalised household income over 48 months. The blue bars measure instability before accounting for social benefits by using market incomes. The red bars add unemployment benefits to market incomes to measure instability after accounting for unemployment benefits. Next, the yellow bars adds old-age benefits to market incomes and unemployment benefits. The green bars adds in educational allowances and thus represents the total measurable effect of social benefits on instability. However, the total measurable effect does not include all social benefits such as child allowances. The analysis is carried out only on households with stable composition over 48 months and whose main employment income earner is aged between 18 and 59. The unit of reference is the individual.

Source: OECD calculations based on the European Union Statistics on Income and Living Conditions (EU-SILC), adjusted by the authors from OECD 2023a.

stabilize, within certain limits, people's expectations about future income streams (Goodin 1990; Goodin et al. 1999). In practice, this is accomplished by coupling welfare benefits to earnings, which involves the possibility that benefits are paid to those who are relatively well-off. Notional defined contribution plans, a key characteristic of the Latvian pension system, are an example for doing just that. The more you earn during your working age, the higher your pension.

Figure 5 shows the effect of social protection on income instability in the Baltic states and other European countries. Social benefits, particularly unemployment an old-age pensions, reduce income variability on average by about 42% within the country sample. This figure likely underestimates the stabilizing effect of welfare as, due to data limitations, it doesn't account for other important benefits, such as child allowances, energy price measures, or disability insurance. Britain stands out as an outlier both for its very high-income variability (coefficient of variation: 0.51) and the minimal impact of its welfare system on reducing this variability (17%). In the Baltic states, the capacity of the welfare system to stabilize living standards is subject to considerable cross-country variation. Latvia is the regional leader, smoothing income instability by 48%, followed by Lithuania and Estonia with 30% and 26% reductions, respectively. In all Baltic countries, old-age pensions tend to have a higher stabilizing effect than unemployment benefits and educational allowances. However, this conclusion is tentative due to limited data, particularly regarding the impact of child and maternity benefits on income variability. We shall investigate this point further in the following section by considering the replacement rate of Latvian old-age pensions.

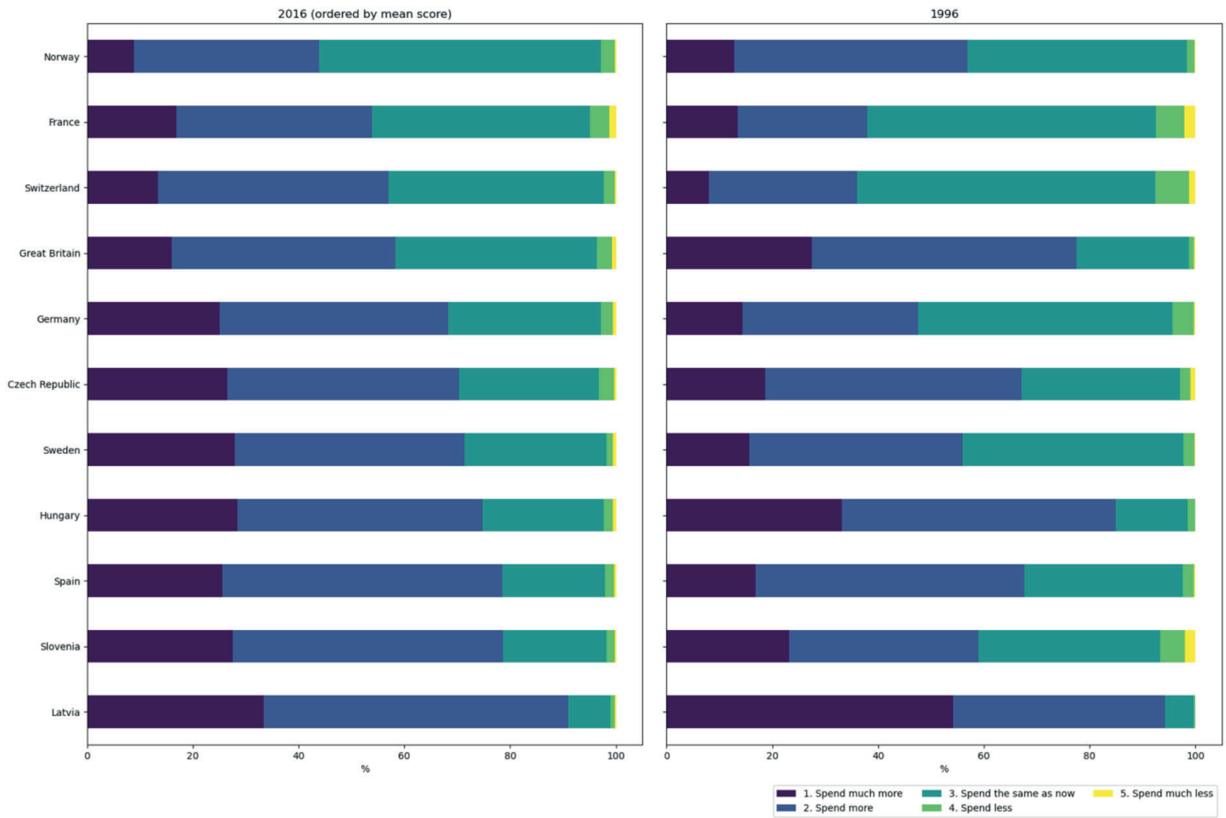
4

ZOOMING IN: REALIZING SOCIAL JUSTICE THROUGH THE LATVIAN PENSION SYSTEM

Latvia's old-age pension system is the largest branch of the Latvian welfare state, accounting for more than 40% of its social protection expenditures. Similar to the situation in many post-industrial societies, the Latvian pension system faces the challenge of juggling two competing objectives. On the one hand, it aims to promote social justice by ensuring that basic needs are met, by fostering equality, and by smoothing income fluctuations across a life course. On the other hand, it seeks to secure financial sustainability amid adverse societal challenges such as an ageing demographic and the increasing impact of new social risks – including precarious and informal work – on social contributions and pension benefits. Survey evidence suggests a wide-spread belief that the Latvian pension system is inadequate to these tasks. Figure 6 shows evidence from the International Social Survey Programme's *Role of Government* module (ISSP Research Group 2023). In 2016, more than 90% of the surveyed Latvians expressed a preference for "more" or "much more" government spending on old-age protection. This figure is the highest among the countries included in the sample and has remained almost constant since 1996.

Context always matters, and it would be imprudent to interpret such evidence without considering the highly particular circumstances underlying the development of the Latvian pension system after 1991 (Vanovska 2006; Aidukaite 2009;

Figure 6
Should the government spend more or less money on retirement? (1996 vs. 2016)



Only countries with data for both 1996 and 2016 are shown.

Source: International Social Survey Programme: Role of Government I-V (1985-1990-1996-2006-2016). (Data file: ZA4747, Version 2.1.0, Variable v40).

Bohle & Greskovits, 2012; Rajevska 2021; Toots & Lauri 2022). In the immediate aftermath of Latvia's restoration of independence, a first wave of pension reforms aimed to detach pension funding from the state budget (by introducing a contributory system) while retaining many key aspect of the Soviet-era system, including retirement ages set at 55 for women and 60 for men, supplemented by a price compensation mechanism. Yet, this initial reform plan was short-lived as it foundered on the harsh economic realities of the early 1990, including hyper-inflation, which made the payment of earnings-based benefits untenable.

A second wave of pension reforms in the mid-1990s established the foundation for Latvia's modern old-age system. The reform process in the Baltic countries was at that time heavily influenced by ideas from abroad, championed by the World Bank, the Swedish government, the finance and insurance sectors, and a host of non-governmental organizations. The contribution of the Swedish government to Latvia's pension reform is well-documented (Müller 2002; Tavits 2003). One key outcome of this collaboration was the adoption of a notional defined contribution scheme (NDC) in the first pillar of Latvia's (but not Estonia's and Lithuania's) old-age system, taking effect in 1996. In an NDC scheme, pension benefits are entirely determined by contributions and 'notional' (government-mandated) investment returns. On some accounts (Tavits 2003), Sweden was using Latvia as a "laboratory" for policy experimentation, testing the implementation of a contributory scheme it had been contemplating for some time and planned to gradually phase in starting from 1995. Latvia thus became the first country to fully introduce a system of notional accounts. It is today followed by several OECD countries, including Sweden, Poland, and Italy.

Recent scholarship has highlighted the significant influence of non-governmental organizations from the US (such as the Heritage Foundation) but also from Sweden (such as the Swedish Trade Council), advocating a pronouncedly market-centric approach to economic reform, on social policy in the Baltic countries (Salyga 2023, Avliaš 2020). According to these studies, the Baltic states, emerging from communism, were particularly receptive to neoliberal ideas favoring deregulation, austere budgeting rules and that place less emphasis on social justice as a guiding principle in welfare reform. The implications of this influence in Latvia's pension system will be further discussed in the remainder of this Section.

4.1 THE LATVIAN PENSION SYSTEM TODAY: AN OVERVIEW

The Latvian pension system contains various layers, incorporating both mandatory and voluntary elements to ensure a comprehensive support structure for retirees. It consists of three pillars and is based on intergenerational solidarity, as well as on the personal interest and responsibility to provide for old age. The main goal of this three-pillar design is to ensure the long-term sustainability of a pension system, adequate income replacement rates, and mitigation of risks at each level.

The first two pillars are mandatory, while the third pillar consists of private voluntary occupational and individual pension arrangements.

The 1st pillar is a pay-as-you-go (PAYG), notional defined contribution scheme that links pension benefits with the whole contribution history. The social security contributions paid are accounted for pension, as well as distributed among the current generation of pensioners. At the time of retirement, benefits are calculated by dividing the amount accumulated in the notional account by the projected cohort unisex life expectancy at retirement:

P = K/G, where
P – annual pension
K – pension capital of the insured person
G – projected life expectancy at a given retirement age (period in years, during which pension payments are planned, starting from the pension allocation year).

The total amount of contributions to the pension capital is 20% of an individual salary (14% is allocated to the PAYG system (1st pillar) and 6% to the funded mandatory system (2nd pillar).

Participation in the NDC is mandatory for all employed and self-employed people over the age of 15. To receive pension benefits, participants must have contributed to the system for at least 15 years (20 years starting from 2025) upon reaching the statutory minimum retirement age (64 years and 9 months for both men and women in 2024; 65 years in 2025). Early retirement is also possible under specific conditions.

The sustainability of the 1st pillar is determined by both demographics (birth rates, death rates, migration, life expectancy, and the age structure of the population) and economic factors (the number of contributors, average wage, and inflation). The Latvian pension formula automatically links the size of assigned pensions to demographic changes, i.e. with growing life expectancy (G) people claiming a pension at the same age and with the same amount of accumulated pension capital (K) would receive lower monthly pensions. The notional pension capital is also annually revalidated based on the national wage bill growth. Therefore, it is affected by the size of the labour force, and fewer working people mean a lower revalorization.

The 2nd pillar is a state-funded pension scheme. It allows the creation of additional savings to the old-age pension provided by the 1st pillar by accumulating and investing a part of the social contributions into the financial market. The investment is made by an intermediary – a fund manager under a previously chosen investment plan. This pillar is compulsory for all social security contributors born after 1 July 1971. Based on the State Social Insurance Agency data (SSIA, 2024a), in December 2023, there were 1.3 million members in the 2nd pension pillar (76% mandatory contributors, 24% voluntary contributors). Approaching the pension age, participants must choose whether the accumulated capital shall be transferred to the individual account of the 1st pillar of pension capital and the pension to be calculated from the total amount or use the 2nd pillar accumulated capital to purchase a life annuity from an insurance company. The assets accumulated in the 2nd pillar may be inherited. At the end of 2023, 68% of all participants of the 2nd pillar aged 64 had savings of more than EUR 2,000 (the minimum amount to buy an annuity policy). 20% of participants aged 64 had savings of only up to EUR 1,000; however, 14% had savings between EUR 10,000 and EUR 30,000, and 1% had accumulated more than EUR 30,000 (SSIA, 2024b).

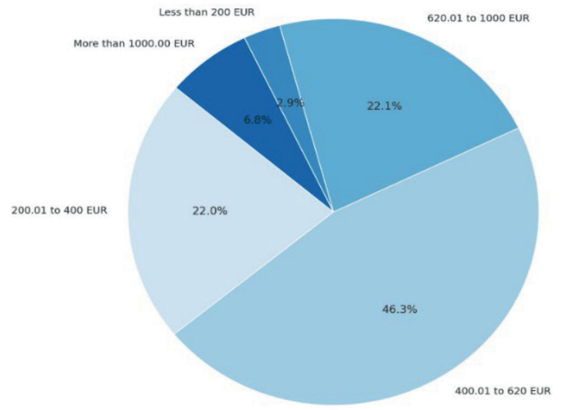
The 3rd pillar is a private voluntary pension scheme. Contributions to the 3rd pension pillar are voluntary and can be made individually or by the employer. Savings in the 3rd pillar, like the funds in the 2nd pillar, are invested in financial instruments allowing to increase the amount of savings in a long-term perspective. According to data from the Finance Latvia Association (2024), at the end of 2023, there were 397,200 members in the 3rd pension plan. An individual who makes contributions to the 3rd pension pillar can receive income tax refunds by submitting the annual income declaration to Latvia's State Revenue Service after each fiscal year. However, Fadejeva and Tkacevs (2022) conclude that in Latvia, engagement with tax-advantaged savings schemes is a recent development and thus remains minimal. Particularly, it is virtually absent among households belonging to the lowest two income quantiles. Predominantly, those in the top income quantile and households headed by a person with higher education or by a younger individual are the ones participating. This situation highlights the concern that without implementing measures like automatic sign-ups for private pension plans (with a possibility to opt out), or targeted financial education programs, the disparity between households with different income levels might widen in the future.

Additionally, Latvia provides minimum pensions for pensioners whose earnings-based entitlements fall below a certain threshold. This policy is aimed at ensuring a basic level of income for all elderly individuals, regardless of their previous earnings and contributions. While this does provide a measure of income redistribution and protection against poverty, the extent of its impact is limited by the overall structure of the pension system (European Commission 2018; 2021).

The minimum amount of an old-age pension depends on the length of the insurance record and is determined by applying a coefficient of 1.1 to the calculation base (given a percentage of the average median income) and increasing the amount by 2% of the calculation base of the minimum old-age pension for each additional year beyond the insurance period required for the old-age pension (currently 15 years). If the person's insurance period in Latvia is:

– at least 15 years, the amount of the minimum old-age pension cannot be less than EUR 188,10 (EUR 171 x 1.1)
– 16 years and more, the amount of the minimum old-age pension is determined by raising it by EUR 3.42 for each year of insurance.

Figure 7
Breakdown of old-age pensions by the amount granted in December 2023, EUR (% of total pensions)



Source: State Social Insurance Agency of the Republic of Latvia
http://www.statistika-vsaa.lv/2020/10/rez10.html.

There is no special social assistance scheme for the elderly. However, those who have a very low income and are not entitled to an old age pension but have resided permanently in Latvia for at least 5 years, of which the last 12 months have been uninterrupted residency, can receive the state social security benefit (EUR 137 per month in 2024) paid from the general state budget.

In Latvia widows (widowers) are not entitled to a survivor's pension but are eligible for a short-term allowance (Ministry of Welfare of the Republic of Latvia, 2024).

Since 2002, pensions have been subject to indexation not only based on price inflation but also on changes in the nationwide wage bill. Indexation differs depending on pension levels, advantaging low pensions.

As of December 2023, around 437,300 individuals were recipients of an old-age pension in Latvia, as reported by the Latvian State Social Insurance Agency (SSIA, 2024c). The average pension amount in 2023 was EUR 563, an increase from EUR 449.88 in 2022, indicating some progress in pension adjustments.

Nonetheless, the detailed breakdown (see Figure 7) shows that 46% of Latvia's pensioners receive between 400.01 and EUR 620 monthly, and 22% receive between EUR 200.01 and EUR 400, highlighting a critical aspect of financial vulnerability among retirees. With 71% of pensioners receiving less than EUR 620 and a substantial 93% receiving less than EUR 1000, the data underscores a pressing concern regarding the adequacy of pension benefits to meet basic living costs. The diversity in pension amounts, ranging from below 200 EUR to over 1000 EUR, illustrates the varied economic realities faced by the pensioner community in Latvia.

Further analysis will utilize a range of indicators from the EU Statistics on Income and Living Conditions (EU-SILC) to comprehensively understand the gender differences, income inequalities as well as economic challenges of the elderly.

4.2 INCOME INEQUALITY AND RISK OF POVERTY

Income inequality among the elderly in Latvia presents a significant challenge, with indicators showing a disparity greater than the EU average. The S80:S20 income quantile ratio – a measure used to assess income inequality – stands at 6.33 in Latvia, notably higher than the EU's average of 4.74. This suggests that the wealthiest 20% of the elderly population in Latvia have more than six times the income of the bottom 20%, highlighting a substantial gap.

The structure of the Latvian pension system is a contributing factor to this situation. Unlike systems that heavily rely on redistributive mechanisms to balance income among different age groups, Latvia's approach is characterized by the use of individual accounts for pension capital accumulation. This model is applied in both the funded schemes and the PAYG pillars. This system implies that the redistributive elements within the same generation are comparatively limited, as pensions largely reflect the contributions made over an individual's working life.

Latvia has implemented some measures to mitigate the risk of poverty among the elderly, particularly those receiving smaller pensions. A key strategy is the partial indexing of pensions, which ensures that smaller pensions are somewhat protected against a decrease in purchasing power. This indexing mechanism serves as a redistributive tool – albeit of limited magnitude – by adjusting pensions to reflect changes in the cost of living, thereby offering better protection for individuals with lower pension benefits.

Despite implemented measures, the situation for older individuals regarding poverty and social exclusion stands out as particularly egregious when compared to the rest of the European Union. In 2022, a striking 42.6% of Latvians aged 65 and above were at risk of poverty or social exclusion, significantly higher than the EU average of 20.2% (see Figure 3b above). This issue becomes even more pronounced for those aged 75 and older, with a rate of 55.1%, far exceeding the EU's 21.3% average.

4.3 GENDER DIFFERENCES

Even though the gender pension gap by age group (65+) in Latvia of 14.8% is below the EU average, where women aged 65 and over receive a pension that is 26% lower on average than that of men, there is a strong gender difference in terms of poverty risk - 60.5% of women over 75 face a risk of poverty, contrasting with 39.6% of men in the same age group.

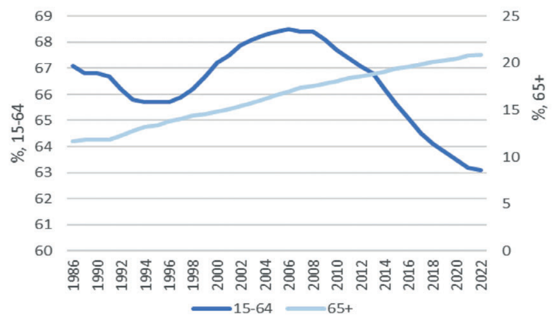
Women live longer, so they rely more heavily on pension benefits. But women also receive smaller pensions due to their lower average lifetime earnings, which leads to increased economic insecurity in old age. According to the Central Statistical Bureau, in 2022 women's average gross hourly wages were 17.1% lower than men's. Parental leave has also a particularly significant impact on income. When a parent, typically the woman, takes parental leave, her wage and career progression are temporarily halted. Coupled with an unequal share of household responsibilities, which can lead her to sacrifice professional development, this results in significantly lower income and, consequently, reduced social security and pension benefits (Fadejeva & Kalnberzina, 2024). During parental leave, the state continues to pay contributions on behalf of the person taking parental leave. However, before July 2022, the basis of contributions was equivalent to the amount of the childcare allowance, i.e., EUR 171 per month. This basis remained the same regardless of whether the person had worked and had paid social security contributions before the parental leave. Thus, only a monthly EUR 34 went into the pension capital during parental leave. From July 2022 onwards, contributions to the pension fund are made from the total amount of parental allowance and childcare allowance, improving the future pension benefits for females who take time off for childcare.

4.4 DEMOGRAPHIC CHALLENGES AND OLD-AGE PENSIONS

The demographic trends in Latvia, reflecting a broader pattern across Europe, point to a significant aging of the population. This shift is driven by a long-term decline in birth rates, coupled with an increase in life expectancy. Projections from both the United Nations (UN) and Eurostat suggest that this aging trend will continue, with Latvia experiencing a notable increase in the proportion of the population aged over 65 – from 12% in 1989 to 21% in 2021 (see Figure 8). This demographic shift significantly impacts the old-age dependency ratio, a crucial measure of the potential support base available for the older generation from those in their working years.

In Latvia, the old-age dependency ratio has undergone a dramatic change. In 1986, there were about six working-age individuals for every person aged 65 or older. By 2022, this

Figure 8
Population ages 65 and above and working age population
(% of total population)

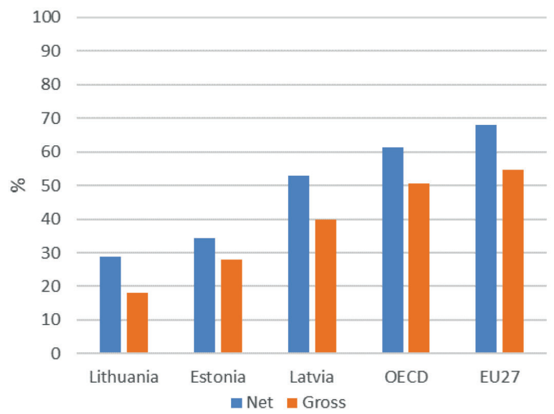


Source: Central Statistical Bureau of Latvia, https://data.stat.gov.lv/pxweb/en/OSP_PUB/START__POP__IR__IRD/IRD010/table/tableViewLayout1.

ratio has halved to only three working-age persons for every individual aged 65 or older (see Table 2). This decline highlights a growing demographic challenge: a shrinking pool of working-age individuals relative to the aging population, indicating increasing pressure on social support systems and the economy.

Eurostat's population projections suggest that by 2100 this ratio will further decline, leaving fewer than two working-aged individuals for each older person. The Baltic states, including Latvia, are expected to face an even more pronounced demographic challenge, with an average of 1.6 to 1.7 working-age people for each older person by the end of the century. This projection underscores the urgency for policy interventions addressing the implications of an aging population, especially concerning pension system sustainability, healthcare, health literacy, and elderly care.

Figure 9
Net and Gross pension replacement rates, average earner, %



Source: OECD pension models. Pension entitlements for the base case.

4.5 PENSION REPLACEMENT RATES

Not only changes within the old-age dependency ratio but also substantial shifts in the pension replacement rates will challenge the pension system in Latvia in the future. The pension replacement rate is calculated as the ratio of a person's pension entitlement (either gross or net) to their pre-retirement earnings (gross or net).

Based on OECD's pension models, the future projected gross replacement rate for workers earning an average wage and maintaining a full career starting from age 22 is around 50.7%. This suggests that, on average, retirees can expect their pensions to be about half of their pre-retirement earnings. However, this rate shows significant variability across different countries, indicating a diverse range of pension system outcomes within the OECD (OECD 2018; 2023b).

In comparison, Latvia exhibits lower replacement rates than the average rates in both the European Union (EU) and the OECD. With the EU averaging 54.8% for gross and 68.1% for net replacement rates, and the OECD averaging 50.7% for gross and 61.4% for net replacement rates, Latvia's position highlights a concerning disparity. In Latvia, for an average earner, the pension is 39,8% of pre-retirement gross earnings, and 52.8% of net earnings (see Figure 9).

This lower replacement rate in Latvia suggests that retirees may face greater financial challenges in maintaining their pre-retirement standard of living.

Based on CSB data in 2023, 22,9% of employees in Latvia received gross wages less or equal to 700 EUR (CSB, 2024). This calculation was based on both full-time and part-time employment. An individual's pension depends on lifetime contributions, and if the contributions are paid from a contribution base just around the minimum wage, the level of the accumulated future pension capital will be very low.

Low accumulated capital, combined with low replacement rates, the absence of a basic pension component, and a very low minimum pension level, will lead to inadequately low pensions in the future. This means that many future retirees may face financial insecurity, with pensions insufficient

Table 2
Age structure in EU27 and Baltic countries.

	EU27	Estonia	Latvia	Lithuania
Year 1986				
Old-age dependency ratio (65+ over 15-64)*	N/A	17,1	17,3	15,5
Year 2022				
Proportion of population 0-14	15	16,4	16	14,9
Proportion of population 15-64	63,9	63,2	63,1	65,1
Proportion of population 65+	21,1	20,4	20,9	20
Proportion of population 80+	6,1	6,0	6,0	5,6
Old-age dependency ratio (65+ over 15-64)	33,0	32,3	33,1	30,7
Median age of population	44,4	42,6	44	44,5
Year 2100				
Old-age dependency ratio (65+ over 15-64)	53,4	54,0	61,6	59,7

* The number of people older than 65 for every 100 people of working age (15-64).
Source: Eurostat (online data codes: demo_pjanind, proj_19ndbi) and United Nations, World Population Prospects (2022).

to cover basic living expenses, thereby exacerbating the risk of poverty among the elderly even more.

Working beyond the pensionable age could allow future retirees to slightly mitigate the impact on their pensions. Many pensioners continue to work, blending their work income with their pensions. According to the OECD Income Distribution Database (OECD, 2023b), in 2020, 40% of the income sources for elderly people in Latvia originated from work. This indicates a reliance on work income in addition to pensions for financial stability in older age. However, the feasibility of this approach is questioned by the health expectancy statistics in Latvia, which indicate a considerable challenge.

In Latvia, the healthy life expectancy at age 65 is significantly lower than the EU average. In 2021, Latvian men and women could expect 4.4 and 5.0 healthy years, respectively, compared to the EU average of 9.5 years for men and 9.9 years for women. Furthermore, since 2005, there has been a decline in healthy life years in Latvia, with a decrease of 0.5 years for men and 0.4 years for women, underscoring a worsening situation in health expectancy.

The contrast of the financial necessity to work beyond pensionable age against the backdrop of declining health expectancy in Latvia casts strong doubt on the long-term viability of relying on continued employment as a solution for pension inadequacy. The situation calls for broader structural solutions to address both the financial security of the elderly and their health and well-being, if the goal is to ensure a retirement period that is both financially sustainable and enjoyable in good health.

5

CONCLUSION AND RECOMMENDATIONS

The evidence reported in the previous sections suggests that the shortcomings identified in Latvia's welfare state largely cascade down to its pension system as well. Presently, pensions in Latvia are inadequate to effectively realize the three fundamental principles of social justice: needs, equality, and income stability. This diagnostic is most pressing regarding the pension system's ability to mitigate old-age poverty and ensure income stability.

– **Needs**: Old-age poverty in Latvia is exceptionally high in European comparison. It disproportionally affects women and intensifies with advancing age. First-pillar pensions, contrary to their objective, have only a minimal impact on old-age poverty risks. Neither minimum pensions nor safety-net benefits offer protection against old-age poverty. The data underscores a pressing concern regarding the adequacy of pension benefits to meet basic living costs. The lack of survivor pensions generates additional poverty risks especially for elderly women. Coverage gaps for people with short careers, maternity interruptions, or employment in micro-enterprises or in the shadow economy are likely to exacerbate poverty risks in the decades to come and lead to increased take-up rates for basic and minimum pensions. Low accumulated capital, combined with low replacement rates, the absence of a basic pension component, and a very low minimum pension level, will lead to inadequately low pensions in the future. This means that many future retirees may face financial insecurity, with pensions insufficient to cover basic living expenses, thereby increasing the risk of poverty among the elderly even more.
– **Equality**: Income inequality among elderly Latvians ranks among the highest in Europe. The Latvian pension system redistributes very little, implying that market income inequalities accrued during working life are largely reproduced in old age. The engagement in the 3rd pillar is virtually absent among households belonging to the lowest two income quantiles. Without implementing specific measures, the disparity among different income level households might widen in the future. Although income disparities between high and low earners within the Latvian population have slightly decreased since the 2000s, it remains to be seen whether this trend will persist in the aftermath of the Covid-19 pandemic and, as one might expect from the experience in more developed European welfare systems, benefit the elderly.
– **Income stability**: Pensions are a crucial instrument welfare states employ to stabilize incomes and expectations of living standards over a life course. Yet, the income replacement rate for Latvians at retirement age, regardless their contribution levels at working age, is low at present and bound to stay so in the future. Savings accumulated in the 2nd and 3rd pillars are insufficient to substantially improve the replacement rate, the latter playing virtually no role among low-earners. Consequently, for those among the current and future generations seeking income stability, predictability, and autonomy beyond retirement age, there are little alternatives to staying in the workforce. The contrast of the financial necessity to work beyond pensionable age against the backdrop of declining health expectancy in Latvia underscores the limited long-term viability of relying on continued employment as a solution for pension inadequacy.

As Bohle & Greskovits (2012) observed more than a decade ago, Latvia's pension reform of the 1990s reflected a concern with macroeconomic stability rather than with social protection. Today, very little evidence suggests any shift from this approach. Elderly Latvians disproportionally bear the cost of conceptions of fiscal discipline that have largely escaped domestic democratic scrutiny and debate. Without a critical reassessment of this deep-seated mode of thinking about the normative priorities of government, significant improvements in the Latvian pension system's capacity to deliver social justice remain unlikely. More specifically, effective pension reform in Latvia hinges on the political willingness to reconsider the post-transition social contract, which sacrifices present well-being of both the elderly (who accept lower pensions) and the young (who pay higher contributions) for future prosperity. Three decades after the big pension reforms, it becomes clear that this contract hasn't lived up to its promises. Instead, facing the demographic, economic, and social realities of contemporary Latvia, it seems to have locked in the very mechanisms that lead to unacceptably high poverty risks among the elderly.

Policy options aiming to address the current deficits within Latvia's pension system with respect to social justice are subject to three broad constraints. First, institutional inertia, path dependency, and transnational interdependencies within the EU context preclude certain changes within the core institutional architecture of the Latvian pension system, such as a departure from the three-pillar system or from the NDC scheme in the 1st pillar.

Second, effective pension reform in Latvia must assume the legal and political feasibility of reforms that move away from budget-neutrality. Independently of the reform paths chosen, improving the capacity of Latvia's old-age system to realize social justice requires expansionary social spending, both privately and publicly. In this regard, Latvia will have to cope with the political challenge of going against the general trend of pension reform in Europe, which today consists in *containing* rather than increasing contributory and non-contributory spending (Hinrichs 2021). However, it is important to remember that the social cost of improving justice in the welfare system will always need to be weighed against the social cost of *inaction*, including the potential loss of social peace and political stability (e.g. through risks of populism) for future generations.

Third, effective pension reform in Latvia must be mindful of the evidence showing that pension reforms tend to evolve along pathways that are shaped by national-level legacies, institutional patterns, and actor coalitions rather than by transnational policy learning (Hinrichs 2021, Toots & Lauri 2022; Lauzadyte-Tutliene et al. 2018; Toots & Bachmann 2010). There is limited usefulness in bids to emulate 'best practices' from other welfare systems, such as the often-referenced Nordic model. This is a particularly relevant insight for policy recommendations in the Latvian and Baltic contexts. In the light of Latvia's distinctive demographic and economic challenges, certain standard options in the pension reform 'tool box' are either impracticable or susceptible to causing adverse macroeconomic responses (ECB 2018) and/or conflicts between different social justice components. Here are three reform approaches that are likely to be ineffective at improving social justice components:

– Improving the replacement rate at retirement by *increasing contribution rates*: the coincidence of low birth rates and high levels of outward migration is likely to offset the effect of increases in contributions due to a deteriorating old-age dependency ratio. What is more, any such move would threaten to overburden employers and the (shrinking) working-age cohorts, rising issues with intergenerational equality.
– Improving the replacement rate at retirement *without increasing contribution rates*, but by overcompensating the worsening old-age dependency ratio (due to adverse demographic change) by mobilizing more people for formal remunerated work (and making them contributors): assuming any mass recruitment of immigrant workers is not politically feasible, the effectiveness of such an approach through employment policy would be severely constrained by the exceptionally high prevalence of the shadow economy in Latvia. In other words, enhanced workforce mobilization in view of a more favorable ratio between pension beneficiaries and contributors would presuppose an incentive structure that pulls workers from the informal into the formal labor market. While this is of course a worthwhile policy objective per se, we believe it is not currently on the cards of pension policy reform.
– Improving the replacement rate at retirement *without increasing contribution rates*, but by prolonging people's working lives. Contrary to the approach sketched in the previous point, the focus here is on the numerator of the old-age dependency ratio, that is, the restriction of access to pension benefits by increasing the normal retirement age or by tightening early-retirement opportunities. However, despite projected increases in life expectancy, the health-related capacity to work of the average Latvian elderly is bound to remain well below EU and OECD average (OECD 2018). What is more, raising the retirement age is not in order as long as elderly Latvians are exposed to age-based discrimination on the labor market (Aidukaite et al. 2021). Consequently, in the foreseeable future, prolonging working lives (even beyond the planned increase of the retirement age to 65 by 2025) may not realistically enhance social justice. Rather, this approach raises concerns about the ethical trade-offs involved: it might increase pension replacement rates and reduce old-age poverty, but it could also perpetuate income inequality by prolonging the effect of market-based income disparities and diminish intergenerational equity by shortening the time elderly Latvians have for self-development before death.

What policy avenues are open? If the goal of enhancing social justice in Latvia's old-age system is unlikely to be furthered by increasing contributions or extending working life, designing an effective instrument to mitigate rampant and increasingly severe old-age poverty is more urgent than ever before. Regarding instrument choice, it is worthwhile to reflect on the recent experience of emergency instruments enacted after the outbreak of the Covid-19 pandemic. Like many of its European counterparts, Latvia has demonstrated remarkable administrative capacity to quickly mobilize budget resources for purposes of social protection during a public health emergency. As recent developments suggest – think for instance of the referendum-backed bill to introduce a 13th monthly pension payout in Switzerland starting from 2026 – the pandemic legacy may have opened a policy window for prompt and decisive action in a 'welfare emergency' too. Thus, in the short run, an instrument to satisfy the basic needs of impoverished and destitute seniors could take the form of a tax- or debt-financed emergency fund.

In the longer run, in view of a more institutionalized mechanism to mitigate the systemic risks for old-age poverty, a political debate should be started about the addition to tax- or debt financed supplements to the first pillar of the Latvian pension system:

- A means-tested supplementary benefit providing assistance in cases where pensions, post-retirement income, and returns from assets do not cover the basic living costs, including (where necessary) long-term care. In order to avoid undesirable redistributive effects, it is crucial that such an instrument is not financed by VAT tax increases, but through progressive direct taxation (perhaps exploiting the much-discussed potential of financial transaction taxes), government debt, or by building up a sovereign wealth fund, say, following Norway's example. Indirect taxes such as the VAT are known to have regressive effects, which might offset the gains of the pension supplement on the needs and equality dimension. It will also be crucial to treat this instrument not as an allowance or a social assistance benefit, but as a legal entitlement, owed to everyone who, for whatever reason, happened to fall through the loopholes of the old-age safety net.
- A pension granted to a surviving partner as a part of the deceased's old-age pension (joint pension plans), mitigating poverty risks and income fluctuations among the elderly in the NDC scheme. Latvia currently has no survivor pensions, which substantially exacerbates poverty risks, especially in old age.

Further policy avenues, given the problems diagnosed in this report, include:

- Improving individual incentives for enhanced participation and savings both in the mandatory 2nd pillar (by curbing employment in the shadow economy) and in the voluntary 3rd pillar. Such incentives could include more flexible schemes enabling pre-retirement access to pension funds, say for entrepreneurial purposes or for the purchase of self-occupied real estate. Additionally, it is worthwhile to reassess the currently restrictive hereditability rules for 2nd pillar funds as well as to consider improving institutional incentives by creating more favorable conditions for employers to make contributions to their employees' 3rd pillar funds.

Extending financial literacy of younger Latvians vis-à-vis occupational pension plans system and the necessity to take preemptive saving strategies in the light of the very high old-age poverty risks.

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REALIZING SOCIAL JUSTICE:

Latvia's Pension System in Focus

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Stable and resilient democracies depend on welfare systems that meet basic needs, reduce inequality, and ensure income stability throughout a person's life. While the three Baltic welfare states differ notably in their approaches to achieving social justice, their capacity for redistribution remains among the weakest in Europe.

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The Latvian pension system reflects these weaknesses and falls short of fulfilling the essential elements of social justice. This is most evident in its inability to mitigate old-age poverty, which disproportionately affects women, worsens with age, and is likely to remain exceptionally high despite recent reform efforts.

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To enhance social justice, effective pension reform in Latvia must prioritize reducing the unacceptably high poverty risks faced by the elderly. A promising policy direction is the introduction of a means-tested supplementary benefit scheme, providing support when pensions, post-retirement income, and asset returns are insufficient to cover basic living expenses, including long-term care.

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When designing pension reforms, Latvian policymakers should avoid citing the Soviet legacy to diminish their responsibility in shaping post-transition welfare policy. They should also be cautious about adopting 'success stories' from neighboring countries without thoroughly analyzing what achieving social justice specifically requires in Latvia.

Further information on the topic can be found here:
https://baltic.fes.de

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