Pension Reform and the Development of Pension Systems: An Evaluation of World Bank Assistance

*Background Paper*

*Latvia Country Study*

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### Abbreviations and Acronyms

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<tr>
<td>GDP</td>
<td>Gross domestic product</td>
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<td>IEG</td>
<td>Independent Evaluation Group (formerly OED)</td>
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<td>ILO</td>
<td>International Labor Organization</td>
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<td>NDC</td>
<td>Notional defined contribution</td>
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<td>OED</td>
<td>Operations Evaluation Department (changed its name to IEG in December 2005)</td>
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<td>PAYG</td>
<td>Pay-as-you-go</td>
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<td>Phare</td>
<td>Pologne, Hongrie Assistance à la Reconstruction Economique</td>
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<td>PSAL</td>
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Preface

This paper belongs to series of 19 country and regional case studies commissioned as background research for the World Bank's Independent Evaluation Group (IEG) report "Pension Reform and the Development of Pension Systems." The findings are based on consultant missions to the country or region, interviews with government, Bank, donor, and private sector representatives involved in the pension reform, and analysis of relevant Bank and external documents.

This case study was authored by Elsa Fornero and Pier Marco Ferraresi in 2004. Elsa Fornero is with the University of Turin and the Center for Research on Pensions and Welfare Policies. Pier Marco Ferraresi is with the Center for Research on Pensions and Welfare Policies.

The authors acknowledge the helpful cooperation of Inguna Dobrja and Lilita Sparane, World Bank; the officials interviewed during their visit to Latvia on October 14–16, 2003; Matteo Migheli for research assistance; and Silvia Maero for helping in preparing their visit and in reading this text.
1. **Evaluation Objectives and Methodology**

1.1 The goal of this report is to provide an external, independent evaluation of the role of the World Bank in promoting and supporting the pension reform process in Latvia after the country achieved independence from the Soviet Union in 1991.

1.2 To perform our task, we based our analysis on both objective and subjective criteria. For the objective aspects, we considered

- The overall design of the pension system in its steady state;
- The timing, costs, and features of the envisioned transition toward the new regime;
- The degree to which the reform was needed, as well as its priority with respect to other reforms; and
- The efforts made by the Bank to adapt its theoretical framework (as described in the 1994 Bank volume *Averting Old Age Crisis*) to the specific characteristics and circumstances of Latvia.

1.3 In terms of subjective criteria, we considered

- The degree of transparency of the reform process;
- The degree of “ownership” of the reform by the Latvian government; and
- The support from the Bank to develop direct and indirect means to sustain the reform and evaluate its performance (e.g., the development of administrative and information systems, the organization of the various institutions involved in the process, etc.).

1.4 The main sources we used were

- Select documents provided by the Bank;
- Interviews with representatives of various institutions and organizations; and
- Select journal articles and papers.

1.5 The structure of this report follows a format suggested by the Bank, which we agreed was useful. Changes were made to the format where we thought it was necessary. The report starts with a brief presentation of the situation of the Latvian pension system in the 1990s—before the Bank’s involvement and before major reform attempts, followed by a description of the evolution of Bank assistance to the reform process, then an assessment of the impact of Bank assistance, and then concludes with an attribution of results.

1.6 The final section discusses the lessons to be learned from the Latvian experience in pension reform and from the Bank’s involvement in the process, ending with a suggested agenda for future action. Finally, the appendixes contain a list of Bank assistance instruments a statistical table for Latvia, and the names of individuals we interviewed.
2. **Background**

**PENSION SYSTEM PRIOR TO REFORMS**

**Macroeconomic Scenario**

2.1 When Latvia gained its independence from the Soviet Union in 1991, it started moving toward democracy and a market economy, both preconditions for participating in the political and economic organizations of the West, in particular, the European Union. In terms of Latvia’s social policy, 1995 can be seen as a significant year. Up until then Latvia mainly had adopted emergency policies as a way of dealing with the devastating effects of the breakdown of the old system. In 1996, macroeconomic stabilization policies, combined with structural reforms (among which the pension reform was prominent) and the start of intensive cooperation with European countries, steadily improved Latvia’s economic scenario, resulting in the country’s 2004 accession to both the European Union and the North Atlantic Treaty Organization.

2.2 The establishment of a democratic society and a market economy required significant resources as well as an impressive amount of legislative work. Subsequent efforts to accelerate economic development—based on the establishment of conditions favorable to the creation of firms and jobs—and to narrow the economic gaps separating the Latvian regions also mobilized administrative and financial resources. In all of these areas, progress (in some cases, *significant* progress) was achieved in a rather short time.

2.3 During the first years after independence, the transition from a centrally planned economy to a market economy understandably caused (as it did in all the countries that underwent the same process) a significant drop in output, employment, wages, and health indicators. Although data for this period are lacking, it is estimated that in the years 1990–95, per capita income contracted, in constant terms, to about half of its original value, while inflation soared to rates as high as over 900 percent a year (see Appendix B).

2.4 From 1996 onward, the economy started to grow significantly—with only a minor lapse in 1999 as a consequence of the 1998 Russian financial crisis aftermath. By the end of the 1990s, the macroeconomic situation seemed to have stabilized and its outlook was generally favorable: a comparatively high average growth rate (5.6 percent per year for the period 1996–2000); a considerably lower inflation rate (reduced to about three percent in 2001); “acceptable” levels (at least from in terms of the Maastricht criteria) for the budget deficit (about three percent of GDP) and the public debt (46 percent of GDP in 2001); a stable currency, and much lower interest rates. With Latvia’s fast growth since 1996, the gap separating it from the European Union’s average per capita income kept narrowing, dropping from a level at slightly more than one-fourth in 1998 to one-third in 2001.

2.5 Many problems remain, of course. Unemployment is stuck at a comparatively high level (about 13–14 percent in 2003, as computed using the International Labor Organization methodology), despite strong economic growth. As in most transition countries, labor productivity is still significantly lower than in the European Union (at
about 35 percent of the European average in 2002). In order to secure sustainable growth, efforts are required to widen and strengthen the economic basis as well as to expand exports, which are essential for production given the very small size of the Latvian market. A further concern is the wide gap in economic activity, income, and social services between those living in the capital city of Riga and the rest of the country.

**Increasing Demand for Social Protection**

2.6 In the area of social protection, the initial drop in income after independence increased the demand for benefits and encouraged or “forced” many elderly workers to retire as soon as possible on early retirement or disability provisions. This phenomenon raised the number of beneficiaries and increased expenditures while public revenues were shrinking, owing to the collapse of GDP and the difficulty in collecting contributions and taxes. Moreover, the high level of the payroll tax rate, although not sufficient to cover social protection expenses, discouraged labor demand while the weak connection between contributions and benefits encouraged either tax evasion or the underreporting of wages and incomes.

2.7 The welfare system inherited from the old regime was designed to meet the special features of a planned economy, for example, with guaranteed full employment, unemployment benefits were practically never considered. When viewed in this light, the system can be described as effective, and even generous, in purely nominal terms. The system provided pensions, short-term cash benefits, and health care as well as other benefits, such as low-cost housing, subsidized goods, and services (heating, transportation). Given the different tasks performed by the system, it was difficult to control expenses and evaluate performance. Moreover, benefits did not include an automatic indexation provision, so adjustments were required in the inflationary environment that characterized the first part of the 1990s. The ad hoc nature of these adjustments, however, created new problems, because they almost destroyed the earnings-related benefits.

2.8 In the aftermath of independence—even without proper projections of expenditure, equilibrium payroll tax rates, or the other usual indicators of sustainability—awareness grew that the system could not be maintained as it existed because of its costs and poor design, which were hardly compatible with a proper incentive structure or the functioning of a market economy.

**A Two-Stage Reform Process**

2.9 As in many other transition economies (see Gillion et al. 2000, p. 561), the reform process followed two paths: a short-term, mostly ad hoc path and a long-term, structural one. The earliest measures were emergency responses to a crisis situation. These measures included the provision of new unemployment benefits and social assistance, to give some help to the most vulnerable groups in the economic transition.

2.10 The second path can be described as a rather courageous attempt to tackle the long-term conceptual, design, and financing issues relevant to the welfare system as a whole. This process, which was strongly supported by the Bank, saw Latvia in the
foreground of the pension reform campaign. Indeed, Latvia takes pride in being the first country to actually implement the notional defined contribution (NDC) system. The rest of this section is dedicated to the earlier interventions. The next section illustrates the structural reforms of 1995.

**Earlier Interventions**

2.11 The system that Latvia inherited in 1990 had been fully integrated with the Soviet Union’s social security system. Starting in January 1991, a new system was set up, which included a reformed pay-as-you-go (PAYG) pension scheme and three other social insurance schemes to finance cash benefits for families (maternity leave and child allowances; health insurance; unemployment subsidies). All of the schemes had to be financed by earmarked payroll taxes and differentiated between dependent workers (38 percent of the firm’s total wage bill, of which 37 percent was paid by the firm and 1 percent was paid by the employee) and the self-employed (19 percent of declared incomes). Personal contributions were allowed and were meant to give women raising children the ability to qualify for pension benefits.

2.12 As for pension benefits, the new law established an insurance mechanism for old-age, disability, and survivorship benefits, complemented by a means-tested social pension provision for all elderly residents (at least age 65 for men, and age 60 for women). The old-age pension scheme combined the eligibility requirements of the old system (retirement ages were 55 and 60, respectively, for women and men, and at least five years of service) with a rather generous formula and a minimum pension provision. Early retirement (up to 15 years less than the standard retirement ages) was allowed in hazardous occupations (about 10 percent of the workforce). The law also established a new and even more generous provision for disability pensions obtainable with a medical certificate, given a minimum, age-dependent service record. As for survivorship pensions, dependent or disabled children were fully entitled, while spouses were entitled conditional upon being over the retirement age and with no pension of their own.

2.13 The benefit formula for these three types of pensions was two-tiered: a basic, flat-rate benefit (80 percent of the minimum level of living) and an earnings-related component. The latter was a function of the individual’s years at work and the pensionable wage, determined by the best consecutive five years within the last 10 years before retirement. It had a ceiling, set at twice the minimum standard of living (with exceptions) and a floor, and was payable conditional upon effective retirement (or on income from work being lower). The disability pension added other flat rates to the previous components, while survivor’s pensions added 40 percent of the deceased’s pension to the basic component. In the case of several eligible survivors, the deceased’s pension was allocated among them.\(^\text{1}\) All pension benefits were tax exempt.

\(^\text{1}\) In terms of comparisons, the average disability pension was greater than the average values of both old-age and survivorship benefits, as shown by the following levels as percentages of the overall average benefit (1991): old-age pensions, 97.78 percent; survivor’s pensions, 96.24 percent; disability pensions, 143.81 percent.
2.14 In macroeconomic terms, the number of benefits of all types increased very rapidly, with disability pensions showing the fastest growth. Consequently, pension expenditure rose from 10.6 percent of total public expenditure in 1990 to about 26 percent in 1993. With respect to GDP, the corresponding figures were 7.8 percent in 1991 and 9 percent in 1993 (over 10 percent in 1994), showing that the reduction in average real benefits was unable to compensate for the sharp contraction of real GDP and the increased number of beneficiaries. Overall social-protection costs rose from about 10 percent of GDP in 1991 to over 15 percent in 1995 (see Fox and Palmer 1999, p. 5).

2.15 To finance the system, the social security tax of 38 percent levied on wages was both insufficient to make the system sustainable and too high to keep firms competitive, and was thus hardly compatible with restoring economic growth. Moreover, apart from tax evasion and the underreporting of income, the collection of taxes was administratively very problematic (in January 1996, when the new system started, the total credit for unpaid contributions amounted to 4.2 percent of GDP).

2.16 Latvia’s demographics were another factor that further contributed to the unsustainability of the system designed by the 1991 reform. Between 1991 and 1995, while the number of pensioners increased, the number of workers for whom contributions were paid contracted, causing an increase in the dependency ratio from about 45 percent in 1991, to 67 percent in 1995 (see appendix B and Fox and Palmer 1999, p. 6). Not only was the system unsustainable for short-term reasons but long-term demographic trends also aggravated the outlook. While in the years immediately following independence, life expectancy decreased, particularly among the elderly (as it did in many transition economies), it was expected that this trend would be reversed in the future, as an essential element of economic development. Combined with a falling fertility rate (an average of 1.4 percent during the second part of the 1990s, compared with a rate of about 2.0 percent in earlier decades), these elements were sufficient (even without a proper simulation model) to make a relatively safe prediction that, without further intervention, expenditure would continue to increase and absorb too many resources.

Conclusion

2.17 The unsustainability of the 1991 model was correctly arrived at not only on the basis of different indicators (both current and prospective), but also on the basis of the views expressed by Bank officials and independent experts providing technical assistance. The challenge was to convince Parliament that a new reform was needed, just when many pressures from various segments of society called for improvements in the existing structure of benefits, and to show politicians the directions for new reforms.

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2 As indicated by the change in the distribution of pension by types, showing a marked increase in the share of disability pensions, which went from 13.98 to 15.88 in a year and a half (June 1991–October 1992).
3 Later, demographic projections confirmed the initial worries. Although Latvia will be characterized for the next 10 years by a relatively youthful workforce, a dramatic change is expected as the small group of members born at the beginning of the 1990s reaches working age, and the larger group of older members retires. Demographic aging will exert the maximum pressure on the pension system by around 2060, when the social insurance system is projected to have 900 pensioners per 1000 contributors. See Ministry of Welfare, 2003.
REFORMS IN 1995

2.18 In January 1995, the government submitted to Parliament a “purpose of legislation” framing a new quite radical, pension architecture based on a three-tiered system. The basic philosophy was to create a sustainable, adequate, and transparent social security system, allowing for less redistribution, lower costs, higher efficiency, and better allocation of risks than the 1991 system. The crucial idea was that, notwithstanding the uncertain connections between social security and economic growth, the new system should “support” development, particularly by avoiding structural financial imbalances and by getting incentives “right.” To achieve this goal, it was proposed that the new system should consist of

- A first pillar, with a PAYG scheme based on a strong relationship between benefits and contributions, and supplemented by a minimum pension provision;
- A second, mandatory pillar, fully funded and financed out of the overall payroll tax rate; and
- A third pillar, consisting of voluntary, private pensions acquired either on a collective basis (with administrative help by the employer) or on a personal basis, through an insurance company.

2.19 The essential ingredients for this construction were

- A clear separation between insurance and assistance schemes: the former to be financed out of independently managed earmarked contributions on earnings; the latter, non-contributory scheme, to be financed out of general taxation, as part of public expenditure on social protection;
- The introduction of a new formula for benefits in the insurance scheme, based on the principle of actuarial fairness; and
- A partial and gradual diversion of the public payroll tax rate to finance the funded component.

2.20 Some very important steps of the reform process were

- The creation and implementation of a supervisory authority for non-banking financial institutions such as insurance companies and pension funds; and
- A fiscal reform aimed at achieving a gradual reduction of the overall social-insurance contribution rate, in order to foster competitiveness (the reduction took place in 2003, from the previous 38 percent to 33.09 percent), and at including pensions and other social security benefits in the income tax base, thus limiting the previous exemption area.

2.21 Parliament started immediately to work on the proposal and in November 1995 gave its final approval on a new bill for the pension system (basically respecting the stated “purpose of legislation”), to be made effective for all contributors beginning in January 1996. Pensions already in payment were not revised.

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4 By an independent institution, later created and called the Social Insurance Fund.
2.22 The new system is thus three-tiered, consisting of a minimum pension provision, the state scheme, and the state fund (later to be privately managed). The minimum pension is guaranteed to all citizens of at least 60 years of age, who on the basis of their contributory history can only claim a very poor pension benefit, below the level of the social pension (maintained as part of the assistance schemes). The minimum does not apply in cases of early retirement.

2.23 As for old-age benefits, the system is of the NDC type. The contribution rate is set at 20 percent, with no ceiling, while the provision of a minimum wage implies a floor. Pension credits for specific periods out of work (military service, child care) are paid for by the state budget on the basis of the minimum wage. Contributions are credited to the worker and earn a return equal to the rate of increase of the wage bill. At retirement, their notional accumulated amount is converted into a pension by using unisex mortality tables; more specifically, the total is simply divided by the expected postretirement life span. The minimum retirement age is set at 60 (with exceptions for hazardous jobs) for both men and women, although the transition is longer for the latter and, notwithstanding the early-retirement provision, maintained up until 2005. Given the formula, working beyond the minimum age is rewarded—or at least is no longer penalized, as it was in the previous earnings-based system.

2.24 The earnings-related formula was maintained for disability pensions. Benefits only cover the working period and are transformed into old-age pensions at retirement, with the worker having the right to the higher of the two levels. Survivorship benefits—restricted to dependent children\(^5\)—were also restructured according to the new NDC principle.

2.25 Benefits of all kinds are indexed twice a year to the consumer price index. Since 2000, the indexation mechanism also takes into account part of the variation in productivity.

2.26 The fiscal treatment of benefits was also revised; tax exemption for benefits over the minimum was cancelled. The tax collection and the administrative structure of social security were also reformed. A decision was made to separate the collection of contributions, which was transferred to the State Revenue Service, from payment of the different kind of benefits. The responsibility for this was handed over to the new State Social Insurance Agency, which would govern the three separate schemes: (i) old age, disability, and survivorship benefits; (ii) health, maternity, and disability benefits; and (iii) unemployment and workers compensation benefits.

2.27 Although it was based on high principles, establishment of the second tier was much more problematic. First, the funded component, the State Funded Pension Scheme, initially expected to start in 1998, had to be postponed because the section of the 1995 bill establishing the fund was not brought before Parliament for approval; only draft legislation for the funded component was prepared in 1998. Notwithstanding uncertainty in the legislative process, a crucial decision to sustain the development of the funded component was to finance it through a diversion of payroll

\(^5\) Survivorship benefits for widows (or widowers) were considered neither a necessity—given the very small difference in the activity rate between men and women, typical of most Eastern European countries—nor fair, given the higher life expectancy of women at any age. These features of transition societies thus reduce, with respect to Western European countries, the scope for a family-tailored social security system.
taxes owed to the NDC PAYG system, with a parallel reduction in benefits. The initial allocation was set at two percentage points, with a planned rise to 10 percentage points by the year 2010, in order to apportion the financing of the pension wealth equally between the funded and the unfunded components (but ignoring the third pillar). The participation of workers younger than 30 was made mandatory, while for workers age 30–49 it was voluntary; workers older than 49 were not included. Perhaps because of risk concerns, given that no guarantee is provided in the new system, it was likewise established that during the first phase (until 2003) assets would be managed by the State Treasury and allocated within a rather restricted class of securities.

2.28 In terms of expected results, the bill anticipated that for the first 10 years (until 2005) the level of expenditure of the first tier was to be one-third lower than it would have been under the old system, and the privately managed funds were to collect approximately 10 percent of total contributions. It was also foreseen, in the longer term, that 40 percent of the pension benefits for the young would come from the second pillar.

2.29 In any pension reform, the transitional rules are particularly important, that is, the rules that define the time horizon needed to reach the new steady state, the specific features of the phasing-in of the reform, and the allocation of its costs. This is because there are costs during the transition to funding a pension system, even when the funding is notional. These costs are higher when the initial conditions imply a very large debt and, of course, are even higher when the real building of funds is also an objective of the new design. These costs have to be distributed among current and future generations. Current members are, of course, affected mainly by the way their “accrued rights” are evaluated. In the case of NDC, this means calculating the “initial capital” to be credited for past years of service, which means

- Reconstructing the earnings histories;
- Assigning contribution rates; and
- Recognizing a rate of return.

2.30 In Latvia, the years of service were recorded, but earnings histories were practically impossible to obtain. It was then decided that initial capital would be calculated by using the years of seniority and by “reconstructing” earnings through current earnings levels, and averaging the 1996–99 records, when possible. This method, rough but probably unavoidable, created disparities in treatment, and thus caused discontent among the population, as well as wrong incentives for workers to finance a high level of contributions, even by contracting debts (see Fox and Palmer 1999, p. 12).

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6 Since 2003, participants have been allowed to place their assets with private managers, who offer a broader range of financial instruments.

7 We are not aware of a provision requiring formal checks of these expected results.

8 When individual records are either unavailable or lacking, at least three different methods are considered for the reconstruction of earnings: the average wage; the age-related average wage; and an ad hoc reconstruction of the individuals’ earnings profile. All models involve some degree of redistribution and policy makers have to choose on the basis of available data, and defend their choice in view of what is right within a given political economic environment (Palmer 2003).
Finally, legislation on pension reform was not a singular event. Many amendments to the basic 1995 law were adopted in subsequent years (11 amendments up until 2002), showing a sort of process by “trial and error,” including responses by political parties to pressure groups during the difficult years of the early transition. The changes brought about relate to clarifying the pension formula, to retirement age, to benefits for special groups (the unemployed, foreign workers), to the required seniority, to pensionable earnings, and to the indexation mechanism. While the cumulative effect of these changes was an increase in real pension benefits, the brake was also activated, particularly in 1999 in the aftermath of the Russian crisis, when the retirement age was increased to 62 for both men and women (again with gradual adjustments and with a corresponding adjustment in the previous provision for early retirement). In any event, irrespective of the frequent changes in government and in the supporting coalitions, the main direction of the reform has been followed, a testament to the basic consensus on reform strategy.\(^9\)

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3. **World Bank Assistance in the 1990s**

**Genesis of Bank Involvement**

3.1 Involvement with reforming the social insurance system has always been a prominent feature of the role played by the Bank in transition economies. The reasons for this are twofold:

- For social reasons—the immediate need to protect the weakest segments of the population from the consequences of the breakdown of the previous system and, in the longer term, the relevance of a well-functioning social security system;

- For economic reasons—the necessity to limit the share of welfare expenditure in the overall state budget and in the GDP, and the perception of the obstacles that various distortions, characteristic of the previous systems, would impose on economic development.

3.2 Two Bank missions visited Latvia in January and February of 1992, in anticipation of the country’s accession to World Bank membership (August 11, 1992). The results of these missions were summarized in the country study, *Latvia: The Transition to a Market Economy* (World Bank 1993). The report highlights (pp. 58–66) the government’s commitment to building a new, markedly different system, one that is more cost effective, more transparent, and based on a clear accounting of social expenditure and earmarked revenues, but at the same time reflecting national preferences. This commitment was at the root of the earlier 1991–92 reforms discussed in chapter 2.

3.3 In the same country study, the Bank showed great concern about the adverse consequences of the economic transition on the weakest segments of the population. In the trade-off between restoring financial equilibrium and protecting the poor, somewhat more weight seems to have been given, initially, to the latter objective. This approach is evident in the area of pensions, where the Bank suggested the temporary introduction of a monthly, indexed, flat benefit, with the aim of protecting the elderly from the high inflation of the early transition period.

3.4 However, insistence on the key economic concepts of cost effectiveness, budget constraints, and market-oriented incentive structure was already clear, providing a new framework for further and more radical future interventions. The Bank was convinced that the pension system introduced soon after independence was unsustainable, so the preparation of a comprehensive pension reform, dealing with all the relevant issues and based on a thorough review of reform options under different economic and demographic scenarios, was also advocated.

3.5 The pension reform strategy was a relevant issue in the 1994–98 country assistance strategies, which reaffirmed the Bank’s technical assistance, and the intention to collaborate through lending instruments. Technical assistance had already been prominent in the Bank’s support during the first two years of the transition. Government officials who were interviewed during our visit to the country confirmed the importance of the Bank’s targeted support in the areas of public sector management, statistical
reporting, and forecasting. The Bank’s lending program specifically addressed health and social protection with a proposed loan for fiscal year 1996.

3.6 Both politicians and government officials in the early 1990s had to lay down the foundations of a brand new economy and were eager to learn, thus providing high returns to targeted technical assistance, and a good starting point for the training of a highly skilled bureaucracy. It was perhaps precisely because of the strong presence of the Bank in this “non-lending field” (support toward education, organization, administration) that led to the institution’s emergence as the main consultant for the Latvian pension reform.

3.7 This “privileged” role was obviously sustained by the clear position assumed by the Bank on pension issues with its 1994 publication of *Averting the Old Age Crisis*. This analysis, which also attracted much criticism (see Orszag and Stiglitz 2000), had indisputable merits too, such as

- Clearly stating the problem (how to provide adequate income support in retirement for a rapidly aging population, not only in rich countries but around the world);
- Providing a neat conceptual framework for identifying a “good” pension system (based on the concepts of a mixed public/private intervention, long-term affordability, risk diversification); and
- Formulating straightforward recommendations for reform directions (the “three pillars” recipe).

3.8 The Bank’s diagnosis of the problems, in particular, determined both the debate and the course of action. Large, public, PAYG systems constituted the only retirement provisions; high payroll tax rates boosted an already large informal sector and exacerbated the financial problems of the pension schemes; the country had a stagnant or falling GDP, coupled with unfavorable demographic projections; and relatively high replacement ratios reflected unbalanced intergenerational transfers. In the view of the Bank, all of these factors made it clear that these systems were simply not sustainable. At the same time, they showed serious problems in terms of guaranteeing decent protection to the destitute elderly and other weak social groups. On the one hand, imperfect indexation mechanisms were inadequate in maintaining the purchasing power of pensions and other benefits in the presence of increasing inflation. On the other hand, both the system’s fragmentation and the benefit formulas allowed for perverse redistribution in favor of privileged groups. The overall picture was made worse, according to the Bank’s analysis, by rapidly changing demographics, characterized by falling birth rates and a prospective increase in longevity, thus highlighting the risk that these countries would be “getting older before getting richer.”

3.9 According to *Averting the Old Age Crisis*, the focal point in devising a good pension design is to understand that “...The choice among alternative arrangements for old age security affects the welfare of the old, because it determines the share of the national pie they can claim. More fundamentally, it affects the welfare of everyone, old and young, by influencing the size of that pie”. Hence, the social security system is conceived not as a separate institution, but as a fundamental component of the macroeconomic framework, implying that social insurance and social protection should be harmonized with the goal of a steady economic growth,
which is the ultimate driving force toward welfare improvements. To achieve this, a good pension system should, on the one hand: (i) provide both the right incentives for the individual to transfer resources from the active to the inactive part of life, and the proper vehicles to do so; (ii) guarantee a safety net for the elderly who have only a poor permanent income; and (iii) also supply adequate insurance against risks specific to old age (health and care). On the other hand, the system should be: (i) sustainable in the long run, (ii) transparent so as to reduce the risk of undue political manipulation, and (iii) relatively immune to distortions in the savings and labor markets.

3.10 As a consequence, the action plan recommended by the Bank is based on the idea that savings, insurance, and redistribution ought to be the three pillars supporting the overall welfare design, with the further provision of some discretionary government interventions among these components, according to initial national conditions, preferences, and cultural factors.

3.11 More specifically, the proposed three-pillars system includes

(i) A public pillar, with the objectives of preventing poverty among the elderly and providing insurance, both across and among members, against aggregate risks such as low returns, inflation, recession, and market failures. This pillar should be limited, in order to leave room for privately funded components, and financed on a PAYG basis, both to compact generations and to avoid “the problems associated with public management of national provident funds” (World Bank 1994b, p.16).

(ii) A second, mandatory, funded and privately managed pillar (in the form of either occupational plans or personal accounts), supporting the income-smoothing function for savings for the population, at large.

(iii) A third pillar, consisting of voluntary occupational or personal plans, providing supplementary benefits for households with good savings capacity, and a correspondingly high propensity to save.

3.12 The pension reform approved in Latvia in 1995 owes much to the basic philosophy of the Bank proposal. Important differences are present, however.

3.13 After the “purpose of legislation” was sent to Parliament in August 1994, seven laws were passed that quite radically reformed all of the relevant sectors of the welfare system. According to the interviews conducted during our visit to the country, the amazing speed at which the laws were approved by Parliament can be explained mainly by the following three reasons.

3.14 First, the preparatory work for the reform to be understood and approved was well done, at least in the “small circle” that was directly involved in it. For example, the “purpose of legislation” was a very important device on which members of Parliament could develop a “shared view.” Moreover, the government organized a parliamentary discussion in March 1995 on an appropriate pension system, where experts and already trained bureaucrats from the involved ministries had the chance to clarify the need for the reform and the main characteristics of a good welfare design, thus preparing the way for rapid approval.
3.15 A second reason was that the second and third readings of the reform project entered the parliamentary agenda during an interim period—just after the elections and before the transfer of power to the new assembly. This “lucky” situation probably protected the approval process from the political pressures of “second thoughts.”

3.16 A third reason had to do with democratic processes being relatively new in the country. The new ruling classes (politicians, high-level bureaucrats, and representatives of newly created institutions, such as the central bank) were firmly convinced of the centrality of the pension reform for a well-functioning market economy and they were prepared to accept the heavy transitional costs as part of the process leading up to independence. They were equally convinced that the serious defects of the previous system could not be easily repaired but required courageous choices. They were also convinced that these would be unpopular, but believed actual opposition would be slight because the trade unions were relatively unprepared to face the new social conflicts and the civil society was not yet organized into pressure groups. In a way, the drive and enthusiasm which characterized this small group of people, more directly involved in the reform process, contrast with the scarce attention devoted to a proper information campaign. While the administration had a clear view of the necessity of the reform and of the specific measures to adopt, the public’s perception of what was happening was quite fuzzy.

3.17 In short, the role of the Bank in shaping the pension system looks to have arisen from the convergence of the Bank’s desire to put into practice the welfare model set forth in *Averting the Old Age Crisis* and of a concrete demand for advice by the Latvian government, which allowed the Bank to intervene in an already lively discussion.

3.18 The interviews we conducted during our visit to Latvia confirmed the fundamental role played by the Bank’s advice in building awareness and competence among policy makers and in shaping the reform. It should be stressed, however, that it was not a case of “take-it-or-leave-it.” On the contrary, the overall Latvian pension design looks, in many aspects, tailored to the national preferences, as expressed in the political debate. This is confirmed by the choice of the NDC (notional defined contribution) formula for the public pillar, which, in contrast to the prescription contained in *Averting the Old Age Crisis*, involves a very low level of redistribution, and a low degree of insurance against risks connected to economic recessions or poor individual careers. Perhaps the emphasis on a separation between (social) insurance and social protection (i.e., redistribution) reflects the influence of Swedish consultants more so than the advice given by the Bank. Other international institutions and many different governments were, in fact, involved in the overall welfare reform project, and also specifically in the pension area: the European Union Phare, United Nations Development Program, along with the governments of countries such as Sweden, Finland, Denmark, the United Kingdom and the Netherlands.

10 Moreover, the idea of “independence” being the counterpart of the sacrifices imposed by the transition was apparently widely shared.

11 True, some people reacted promptly to any chance of opportunistic gains, as shown by the lapses in the method of calculating the initial capital, which induced some people to borrow money in order to pay high contributions in the reference year. See chapter 2.

12 The Swedish International Development Co-operation Agency specifically supported a social-insurance reform project.
DESCRIPTION OF BANK ASSISTANCE

3.19 The documents provided by the Bank mark the various stages of the Bank’s involvement in Latvia’s transition toward a market economy and, specifically, in the pension reform process.

3.20 In its July 1994 review of public expenditure, the Bank stressed the dominant role of pensions and, more generally, of social programs for individuals and families as a potential factor of financial instability. Further parametric changes, beyond the measures already undertaken in 1991, were advised: an increase in the retirement age, its equalization between men and women, a reduction of benefits for working pensioners, and a tightening of eligibility requirements for disability.

3.21 The scope for a more comprehensive reform was also anticipated in the review, probably with the purpose of preparing the ground for subsequent, unavoidable interventions. A move in the direction of a multi-pillar system was thus recommended, although only after a careful and detailed analysis of its fiscal and financial consequences and depending on the realization of a number of preconditions, such as a detailed program of how to finance the transitional deficits and the development of an adequate framework for pension funds, in terms of well functioning financial markets and good supervision.

3.22 The evolution of the Bank’s assistance in this area can be traced to the country assistance strategies developed since 1994 and to the various lending and non-lending instruments envisaged.

3.23 The mid-1990’s country assistance strategy represented a shift in the Bank’s strategic focus from supporting stabilization and early structural policy measures to assist the government in deepening structural reforms and promoting investment. This shift was fully consistent with Latvia’s fair success in stabilizing the economy.

3.24 Streamlining and strengthening social insurance schemes was indicated as a strategic priority. The Bank planned to monitor the social consequences of the necessary adjustments and provide advice to ensure sustainability of the cash transfer system. Technical assistance was also mobilized for the new pension system project (then under discussion for presentation to Parliament for approval) and for the design of household budget surveys.

3.25 The financial crisis of 1995 contributed to revisiting the strategy. The interviews we conducted during our visit drew attention to the double effect of the crisis on the pension system. On the one hand, it made it more difficult to sustain expenditures. On the other hand, it undermined the early confidence of people in financial markets and suggested more caution in the launching of the funded pillar, planned for 1998. This major drawback in the “funding” strategy resulted in the decision to keep the collected funds in the second pillar, at least in the initial stage, strictly under public management, instead of transferring them to the market.

The crisis resulted in heavy losses for households, financial institutions, and the public budget: 40 percent of the banks’ assets and 53 percent of deposits were lost; 15 banks (including the largest, Banka Baltija) were closed, while the consolidated fiscal budget moved from a small surplus in 1993 to a deficit of 3.1 percent of GDP.
3.26 In November 1996, the Bank, in a response to the crisis and in cooperation with the IMF, granted a structural adjustment loan to the Latvian Ministry of Finance; in parallel, the country assistance strategy was reviewed. Within the updated country assistance strategy the objective to improve the sustainability and effectiveness of social insurance and social protection schemes was addressed with a specific investment loan for the implementation of the welfare reform. Given the importance of the pension component within the whole welfare system, this project constituted the single major intervention specifically addressed toward the implementation of the pension reform.

3.27 Other specific goals of the investment loan were

- Restructuring the social security system;
- Creating a good regulatory framework for private pension managers;
- Improving the design and administration of social assistance, at both the central government and municipality levels;
- Building expertise in the monitoring and evaluation of social policies, and in the simulations of outcomes of different demographic and economic scenarios.

3.28 The first goal, social insurance development, was estimated to cost US$32.15 million, and was directed at improving policy design, developing system administration (contribution recording and benefit administration), supporting organizational change (project planning and management, financial management, communications, human resources development, and the introduction of an object-oriented database), and supporting information technology (technology platforms, telecommunications and networking, and information programming).

3.29 The second goal was the regulation of privately managed pensions (US$0.44 million), which included legislative development, system supervision (assisting the Inspector for Private Pensions), training and supervision of the personnel involved in management, and technical assistance to implement a program of communication for private pension plans.

3.30 The third goal was the administration of social assistance (US$2.90 million) targeted at improving policy development and implementation of social assistance, and financing the Kandava pilot project—its evaluation and dissemination.

3.31 The fourth goal, social policy monitoring and evaluation (US$1.89 million), consisted of improving local monitoring, and developing analytical capacity as well as a social policy research program, also to be reviewed in an annual social report.

3.32 The total cost of the project was estimated to be about US$ 38 million, more than twice the amount of the loan. The project lasted until the end of 2002 and had,

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14 In addition to the Ministry of Finance, agencies responsible for Latvia were the Ministry of Welfare, the State Social Insurance Fund, and the Kandava Municipality.
15 The Bank clearly advocated the need to improve skills at the local level and communication flows among local agencies and ministries.
16 An overall evaluation of the project, commissioned by the Ministry of Welfare, was conducted by PricewaterhouseCoopers in 2003. According to their report, the project reached its objectives almost completely.
consequently, many interactions with other programs including subsequent country assistance strategies which included assistance to help Latvia design and implement an integrated program for sustainable growth and, in particular, the Programmatic Structural Adjustment Loan (PSAL), which focused on implementing various topics related to the overall efficiency of the pension system. The interventions programmed by the PSAL constituted support and completion of the core reform financed through the investment loan. There was, therefore, no overlap but, rather, a complementary continuity.

3.33 An important feature of the project was the mix of lending instruments and technical assistance (very often non-lending instruments are associated with loans; a synthesis of the lending and non-lending instruments is reported in Appendix A). A great deal of technical assistance was devoted to creating the complementary conditions for the reform to be effective, starting with “educational” support, which was to provide involved personnel with the new concepts and frameworks, familiarize them with the new system, and develop evaluation and diagnostic competence. Expertise was also required in the legislative process, in the writing of laws, and in the complementary documents so as to ease parliamentary discussion, to reduce opposition, and to aid the formation of a consensus. A very important element of these non-technical instruments was the project directed at addressing distributional issues, in general, and poverty, in particular, as documented by the 2000 World Bank reports on poverty assessment. Both the documents and the interviews confirm that the Bank’s concern was as much on the reform itself as on complementary factors to make it effective and efficient.

3.34 Another good feature of the Bank’s technical support was its distribution among various Latvian institutions: the Ministry of Finance, the Ministry of Welfare, and the State Social Insurance Fund were the main national counterparts in the field of social insurance and social assistance. Local municipalities were also involved, with the aim of increasing the cooperation with the Ministry of Welfare in the search for the best practices in the provision of services, and in their dissemination. The Kandava Municipality, in particular, was selected to conduct a pilot project based on the new rationale of cost-effective programs, aimed at providing social services and social assistance more targeted at meeting individual needs, and avoiding institutionalization.

3.35 Furthermore, it should be stressed that technical assistance was conceptually separate from the loan, even when it was a fundamental component of the lending strategy—it was related to the project, but its cost was borne directly by the Bank, with no transfer of money to the borrower state. The importance of this aspect of the Bank’s support was usually acknowledged in our interviews with representatives of the main institutions involved.17,18

17 Both the competence and commitment of the Bank’s technical personnel were recognized in an appreciative fashion, even with open gratitude (possibly with the exception for the technical assistance on IT). One interviewer, for example, described the Bank’s assistance methodology in the field of law formulation, as composed of four steps: exemplification, drafting preliminary outlines, organizing seminars and conferences for specific groups, and training discussions in the “shadow working groups” with interested people). Another stressed the role of the Bank in the training of lawmakers and bureaucrats, also adding that “it is possible to notice the difference between executives trained by the Bank’s consultants and the others.”
4. Assessment of Development Impact

OUTCOMES

4.1 The following assessment will examine both the relevance and the efficacy of Bank assistance to the Latvian pension reform. Relevance indicates the extent to which the objectives of the overall assistance and of individual projects were consistent with the country’s initial conditions, needs, and development priorities. Efficacy indicates the extent to which the objectives were achieved.

Relevance

4.2 The core point under relevance is whether the pension reform was really a priority in the context of the early years of Latvia’s transition toward a market economy. Before answering this question, however, some preliminary questions help to substantiate the specific content of relevance:

(i) Is the reform supportive of economic development?
(ii) Does it also provide adequate protection for the less fortunate members of society and, more specifically, does it aim to reduce the distributional disparities among households, genders, and regions (without burdening future generations with too-large implicit obligations)?
(iii) Does the reform strike a good balance between efficiency and redistribution, between financial equilibrium and equity?

4.3 Proper answers to these questions would require a much more detailed analysis than is possible in this report, which has to rely on an inevitable degree of approximation (for example, downplaying cultural aspects or the relative position of men and women in Latvian society), thus somewhat restricting the wider considerations that the people directly involved in the reform process adopted.

4.4 Regarding the first question, on the reform’s role in supporting economic growth, it must be recalled that Latvia almost completely had to rebuild its economy. The productive sector was largely inefficient, privatization was difficult and slow in providing results, entrepreneurship had to be built from scratch, employment was decreasing, inflation was soaring, and public finances showed various kinds of imbalances. No less disappointing was the social context, with growing poverty.

4.5 Given this picture (which is approximate but is supported by statistical data (see appendix B) and by our interviews) it is difficult, even from an ex post perspective, not to share the view that reconstructing the overall system of social security and social assistance was a true priority. Credit has to be given to the successive Latvian administrations for embracing the view, as well as to the Bank for consistently sustaining and supporting it, that household security regarding old age, disability, and other mishaps was given at least the same consideration as production in the reconstruction of the economy, and the building of a market system and democratic institutions. We believe the strategy was a good one, being both farsighted.

and based on sound economic principles. We also share the idea that social insurance and social protection systems are important factors in the determination of overall economic performance, their effects on savings and work choices, as well as on the functioning of capital and labor markets, and ultimately as a precondition for social peace. The envisioned reform rightly tried to achieve these objectives by avoiding financial imbalances as well as microeconomic distortions, and by encouraging household savings.

4.6 In addition, the Bank paid considerable attention to such issues as the allocation of risk, which is the basis of the multi-pillar system prescription, and to the scope for joint public and private involvement. True, the actual method adopted by the Latvian government to realize this model was influenced by the absence of necessary preconditions (just to mention one, a supervisory agency on the financial non-banking system) and the need to create them. In particular, the reform involved building the foundation of a privately managed pillar, but no regulation on pension funds existed. During the last part of the 1990s, considerable financial resources as well as non-lending supports were oriented toward the creation of a sound environment and good regulation for private pensions, in order to increase the confidence of workers and households in the second pillar (to be gradually taken out of the state fund, with encouragement for people to opt in favor of private fund managers) and in the third pillar.

4.7 Regarding the second question, protecting the poor, it is hard to dispute the belief that a democratic society should not forget its less fortunate members. Even with a lack of proper definitions and indicators to recognize and assess poverty as a social problem (socialist societies, which were theoretically based on egalitarianism, were not equipped for that), it was abundantly clear that the country was very poor. Poverty was empirically documented by the rise in the demand for social services and benefits in kind, as well as for cash transfers after the collapse of the Soviet system. It was a demand that the country was not equipped to confront and even less able to satisfy because the supply side of the social protection system, although improved with respect to the original Soviet Union type of assistance, was effectively inadequate, in terms of both resources and administration, to deal with the new problems posed by the spread of poverty.

4.8 The Bank strategy openly recognized this, by mitigating its insistence on concepts like the financial sustainability of the welfare system and the cost effectiveness of individual programs, and by suggesting the introduction of a minimum pension provision. In terms of objectives, all of this is fine. In practice, however, if historical circumstances are taken into account, the difficult situation of the elderly could probably have received more comprehensive consideration. Present-day pensioners have experienced, in the course of their lifetimes, first the German and then the Soviet occupations and they can hardly be said to have been given their fair share of lifetime opportunities. We cannot completely dispel the doubt that extra effort could have been made to take account of these special circumstances, perhaps in the form of an ad hoc indemnity. This could have been achieved without changing the general principles of the new system, which relies upon proper insurance mechanisms (financed out of earmarked contributions) and complementary redistribution mechanisms (financed out of general taxation) where insurance is not possible or much more problematic.
4.9 Apart from the system design, it was realized that, to be effective, the strategy of protecting the poor required reduction of the bureaucratic “distance” between agencies delivering services or providing cash transfers and the poor themselves. This implied both a fundamental change of approach in the administration and an effort to reduce geographical disparities, i.e., the regionalization of assistance on efficient terms. This last aspect attracted considerable attention and resources, as shown by the Kandava pilot project.

4.10 The third question, on the trade-off between efficiency and distribution, constitutes the foundation of the efforts to effectively separate social insurance from social assistance and to strike a good balance between the two. In our view, this separation represents one of the best features of the Latvian reform. A pension system that is organized according to actuarial principles and works via an insurance mechanism is a strength rather than a weakness, regardless of its private or public nature. This is exactly what the Latvian NDC PAYG system tries to be—an attempt not to waste resources through the dead-weight losses and distortions that typically characterize many PAYG pension systems, rather than a sign of negligence and disregard for those in need. The economy, though, can gain by financing social assistance through progressive income taxation and not on earmarked payroll tax rates; this should not necessarily bring fewer resources to the schemes. On the contrary, because the separation represents another important element in the effort to strengthen economic development, it could mean a bigger pie. While this separation is not easily achieved in practice, Latvia’s solution seems to represent an adequate answer.

4.11 Within this framework, it is then possible to go back to the core point of the relevance issue and claim that the social security and social assistance reform indeed had the kind of priority that the Bank attributed to it and succeeded in persuading its counterpart to share. The evaluation of relevance is summarized in table 4.1.

<table>
<thead>
<tr>
<th>Features</th>
<th>Relevance</th>
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<tbody>
<tr>
<td>Supporting economic development</td>
<td>High</td>
</tr>
<tr>
<td>Sheltering the poor and reducing distributive gaps</td>
<td>Substantial</td>
</tr>
<tr>
<td>Striking a good balance between efficiency and redistribution</td>
<td>High</td>
</tr>
<tr>
<td>Overall evaluation of relevance</td>
<td>High</td>
</tr>
</tbody>
</table>

Efficacy

4.12 It is appropriate to observe that: (i) the reform appears to have been effectively implemented and to have profoundly changed the Latvian system; and (ii) the role of the Bank was crucial not only in shaping the new pension architecture, but also in implementing it.

4.13 To substantiate these judgements, efficacy will be assessed with reference to the same issues considered in the evaluation of the reform relevance, i.e., by adopting

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19 It is difficult, of course, to establish whether the scope for introducing the NDC formula in the PAYG system derived from the need to separate insurance from assistance or whether it was the other way around, the idea of NDC having been endorsed before and bringing the separation with it. They are, in fact, complementary features.
as guiding criteria: (i) support to economic development; (ii) the protection of the poor; and (iii) the trade-off between redistribution and efficiency.

4.14 On the first point—support to development, two elements have to be stressed: (i) a prospectively balanced first pillar will not put an undue burden on future generations, thus preserving their contribution to economic development and also leaving future policy makers’ hands free; (ii) the introduction of the funded pillars involves a potential increase in national savings.

4.15 The long-term simulation model built by the Latvian Ministry of Welfare (which we consider not only reliable but also a great achievement in itself) shows, for the first pillar, surpluses and deficit periods somewhat alternating along an overall balanced path.

4.16 It is too early to assess whether pension funds will strongly contribute to the overall savings rate. At present, savings shows a positive trend (14.1 percent in 1995, 16.7 percent in 1999, and 18.6 percent in 2000), but it is likely to derive mostly from economic growth (+6.6 percent in 2000 and US$2,870 per capita gross national product; as against –0.8 percent in 1995 and US$2,420 per capita gross national product) rather than from the pension reform. Pension funds, however, will very likely help by providing some degree of “popular ownership,” strengthening financial markets, increasing resources available for investment, and improving the allocation mechanism. In this area, the Bank was particularly successful in promoting—through technical assistance, monitoring, and training programs—a regulatory system for non-banking institutions.

4.17 On the second point—sheltering the poor, the long-run impact of pension reforms on retirement income should be positive, with a prospectively balanced “pension portfolio,” equally split between the notional and the funded defined-contribution schemes. Of course, the capacity of this pension portfolio to deliver good pensions, given the payroll tax, will crucially depend on the performance of the economic system and of financial markets. Some mistakes were made, however, in the first phases of the implementation, and had to be corrected with subsequent amendments. They concerned, in particular, the calculation of the initial capital on the basis of a very limited number of individual wages. This methodology favored the opportunistic behavior of a few free riders, while strongly penalizing the workers with low wages in the reference years. The severity of the treatment of the older members should not be considered a mistake, but in our view can be regarded as a weakness of the first phase of the reform.

4.18 The third point—the balance between redistribution and efficiency, strongly relies on a clear separation of assistance and insurance, as highlighted above. The poverty line is currently set at 35 lats per month, and 33 percent of the population is below that level; the minimum guaranteed income is 15 lats. The Statistical Bureau, however, considers 93 lats to be the minimum income needed to live a decent life. According to our interviews, this figure appears to be quite objective, but about 95 percent of the population lives below it. The law on social assistance appears to be well designed and, at present, adequate redistribution seems to suffer from the poor situation of public finances (which will probably improve with good economic growth) rather than from a poor normative design.
The efficacy of the Bank’s work has been strengthened by its ability to build an understanding of economic issues shared by politicians of all denominations so that, notwithstanding rather frequent government changes over the decade, the reform principles were never disowned and implementation substantially proceeded along the established path, with only a few discrepancies. At the end of the period, the main targets had been reached, from those related to the new first pillar to those involving the creation of a favorable financial environment for the second pillar. Table 4.2 summarizes the evaluation of efficacy.

Table 4.2: Evaluation of Efficacy

<table>
<thead>
<tr>
<th>Features</th>
<th>Efficacy</th>
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<tbody>
<tr>
<td>Support to economic development</td>
<td>High</td>
</tr>
<tr>
<td>Sheltering of the poor and reducing distributive gaps</td>
<td>Substantial</td>
</tr>
<tr>
<td>Striking the good balance between efficiency and redistribution</td>
<td>Substantial</td>
</tr>
<tr>
<td>Overall evaluation of efficacy</td>
<td>Substantial</td>
</tr>
</tbody>
</table>

Overall Outcome Evaluation

The overall evaluation takes into account both relevance and efficacy, and can be seen as the extent to which the major relevant objectives of the project were achieved or are expected to be achieved. Table 4.3 summarizes the overall evaluation of outcome.

Table 4.3: Overall Evaluation of Outcome

<table>
<thead>
<tr>
<th>Item</th>
<th>Rating</th>
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<tbody>
<tr>
<td>Relevance</td>
<td>High</td>
</tr>
<tr>
<td>Efficacy</td>
<td>Substantial</td>
</tr>
<tr>
<td>Overall outcome evaluation</td>
<td>Satisfactory</td>
</tr>
</tbody>
</table>

INSTITUTIONAL DEVELOPMENT IMPACT

This section evaluates the Bank’s role in strengthening the development of institutions, and in building local competence and skills. The institutional development impact will be assessed according to its relevance and efficacy, while the requirements to make the reform sustainable in the long run (after international help is gone) will be discussed later.

Regarding the relevance of the Bank’s action for institutional development, the Bank should be praised on how it tailored the interventions to Latvia’s initial conditions, such as political instability, administrative weaknesses, the need to substitute old ideologies with new “philosophies,” and the lack of information and specific expertise. Many efforts and substantial resources were devoted to organizing the dissemination of concepts and analytical tools, on the one hand, and the collection of data and statistical information, as well as the definition of the procedures to be adopted by the various agencies, on the other hand. The organizational structure of these agencies was also inspired by efficiency and efficacy considerations.

20 For additional information, see World Bank 1993, pp. 65, 66; World Bank 1994a, pp. 11, 12; World Bank 1996, pp. 2, 3; World Bank 1997a, pp. 3, 4, 6, 7; World Bank 1997b, pp. 2, 3, 5–9, 16; World Bank 2001a, pp. 3, 4, 22–24; World Bank 2000b, pp. 9, 10, 57, 59–70, 81.
4.23 The efficacy of the Bank’s efforts directed at capacity building strikes an overall positive note: a high level of skill and a high sensitivity to economic incentives and to prudent budget management was clearly perceivable in our interviews with all the officials who took part in the Bank’s training programs. The previously mentioned macrosimulation model of the Latvian Ministry of Welfare is a noteworthy policy instrument. An independent body—the State Social Insurance Agency—was created to administer records, distribute pensions, and provide services and information to workers and pensioners. Furthermore, as far as the second pillar is concerned, the agency takes a neutral attitude and does not appear to have a biased view with respect to peoples’ choices of pension products and fund managers. The principle of avoiding duplication of functions was taken into consideration, particularly with reference to the collection of contributions, which was assigned to the State Revenue Service because of its greater expertise in this area.

4.24 Building an integrated administrative apparatus requires sophisticated information technology and the Bank’s advice was crucial in this area. The complexity of the information-technology problems, however, was probably underestimated and a certain number of delays penalized the overall outcome, although to a certain extent, this delay has to be considered inevitable.

4.25 Several evaluations addressed this issue, and confirmed the picture we drew from our interviews. The cost of the information-technology project, was forecast to exceed the budget by about 20 percent; cooperation with the contractor IBM was not fruitful; and independent evaluations confirmed its breakdown.

4.26 The consequent strategy was to develop the information system mainly by using the in-house resources of the State Social Insurance Agency, and this task is not yet accomplished. This evidence raises concerns, given the outdated structure of the present information system, which is certainly inadequate to provide the public with the detailed information required by a scheme based on personal accounts, as well as to produce good communications and synergies between local and central offices. Latvian officials have, however, proven to be truly effective in meeting all the other planned goals, as well as in developing new skills, so that meeting the information-technology targets is certainly not impossible. Given the importance of the information technology for the successful implementation of the pension reform, however, a close monitoring of the process should be done.

4.27 In conclusion, our overall judgment is that the Bank’s work effectively developed an adequate administrative capacity on the main aspects of policy making, problem diagnosis, appropriate formulation and implementation of policies, and work monitoring. Table 4.4 summarizes the overall evaluation of institutional development impact.

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<th>Item</th>
<th>Rating</th>
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<tbody>
<tr>
<td>Relevance</td>
<td>High</td>
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<tr>
<td>Efficacy</td>
<td>Substantial</td>
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<tr>
<td>Overall institutional development impact evaluation</td>
<td>Substantial</td>
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</table>
SUSTAINABILITY

4.28 Generally speaking, sustainability can be defined as the capability of the system to deliver adequate pensions, while substantially maintaining financial equilibrium (if not year by year, then at least in the long run), even under foreseeable negative shocks. “Adequate” pensions can be achieved by a sufficiently high contribution rate; a “good” composition of the pension wealth; relatively high returns to contributions (or at least uncorrelated returns, able to partially compensate for a shock in one of the portfolio components, either funded or PAYG). A system that corresponds to this stylized picture is, in our view, sustainable. How does the Latvian pension system fare in this respect?

4.29 In this section, sustainability will be assessed from two different perspectives—economic and political. Economic sustainability will be considered not only in terms of internal consistency, but also with respect to the reform’s ability to withstand negative changes in both demographic and macroeconomic variables. Political sustainability will be assessed in terms of popular support for and political willingness to proceed with the reforms, and in terms of continued capacity building.

4.30 The Latvian reform produced a new pension system which appears not only transparent and flexible, but also robust from a financial and an actuarial perspective. First of all, the reform is based on a notional-defined-contribution formula, only mitigated by a few redistributive provisions. The internal return to contributions, given by the rate of growth of the wage bill, is consistent with the system’s long-run financial equilibrium, while the assistance components will be paid for by the share of the total payroll tax rate not credited to the pension account, from transfers from the state budget, or from transfers from other social insurance schemes. This means that, while the application of the actuarial principles will not remove all the subsidies in the public system, they will be transparent and will not be a source of financial imbalance, or create questionable disparities (as is often the case when subsidies are embedded in the pension formula).

4.31 The capacity of the first pillar to deliver its adequate share of the overall pensions will depend crucially on economic growth and employment. Macroeconomic prospects are, however, beyond the scope of this evaluation. The relevant question is whether the relatively low contribution rate targeted for the first pillar in the steady state (to be reached, as far as the payroll tax rates are concerned, in 2010) is sustainable: 10 percentage points out of 20, with the rest apportioned to the second pillar. While there is no clear economic rationale for the 50/50 rule, the high priority that Latvia attributed to the development of financial markets, as a precondition for investment and growth, has to be seriously considered. It is also possible, however, that this means subtracting too many resources from the PAYG pillar.

4.32 The second pillar itself will also benefit from economic growth, which is complementary, by providing households with the resources necessary to sustain the financial markets, and which indirectly contributes to their performance and to the returns of the funded component.

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21 As of 2003, the contribution rate is fixed at 24 percent, of which only 20 percent is credited to pensions.
4.33 The trade-off between second-pillar development and first-pillar sustainability was mirrored in our interviews. Interviews conducted during our visit highlighted two different approaches to the introduction of the second pillar. A more “extreme” view maintains that an even more rapid transition to the full implementation of the funded component, implying an anticipation of the equal apportionment of the 20 percent payroll tax rate between the first and the second pillar, would be advisable notwithstanding the initial drawbacks. A more “prudential” approach advocates a slowing of the phasing-in of the funded component, pointing to the negative effects of withdrawals of resources from the first pillar.

4.34 The first approach considers that the current high economic growth rate and the still relatively small number of workers contributing to the second pillar would reduce the net cost of the payroll tax diversion, thus mitigating the pressure on the first pillar. By the same token, shifting the responsibility for the second-pillar assets from the state treasury to private managers would not encounter strong opposition because the numbers involved are quite small. This approach is clearly influenced by the idea that in the long run present favorable conditions are destined to disappear, for both economic and demographic reasons, thus implying that the country must make an effort to avoid “growing old before getting rich.”

4.35 The second approach also assumes there will be “rainy days” for wage growth and for economic growth, in general, and advocates a more prudent transition on the basis of the strong Bank-induced sensitivity of bureaucrats to the state of the budget, as well as the widespread perception that the expected return to funded pension wealth might prove overly optimistic, and the risk underestimated. While the relatively low level of the Latvian public debt might allow a certain degree of freedom in facing prospective budgetary problems, it is certainly difficult to dismiss the risk argument (particularly after the 1995 financial crisis, which is still present in the public’s memory).

4.36 Although the officials we interviewed may be broadly considered as sympathetic to either the first or the second approach, curiously, none of them really questioned the final objective of an equal division between contributions to the first and the second pillar.

4.37 A further issue concerns the long-run economic sustainability of a system that, particularly in the initial stage, but also presumably in a future steady state, places (part of) the second-pillar funds under the management of the treasury, thus allowing the same institutional body (although by two different agencies) to be both seller and buyer of government bonds.

4.38 Moreover, we have to stress that while the pension reform has been completed and the second pillar is ready to work, a related process, i.e., privatization, has experienced some delays. The creation of a potentially large collector of financial investments has not been supported by the full implementation of the removal of state-owned companies. If completed, the privatization plan would have sustained the development of the financial market; its delay would likely cause drawbacks for pension-fund operators.

4.39 Although the Latvian regulatory framework is now, apparently, quite effective, it lacks an operations tradition and, although the accession to the European
Union might open wide the investment opportunities to pension funds, the domestic market is still very narrow, and pension funds managers may be exposed to political risk if their hedging strategy is strongly based on government bonds.\textsuperscript{22} Again, although for Latvia the problem looks to be less critical than for other former Communist countries, we tentatively agree with Peter Diamond’s statement:

\begin{quote}
I think we have to recognize that individual accounts are much harder to set up and run for a country with an inadequate capital market than a lot of people suggest. In some former communist countries, with no capital markets and no regulatory ability, setting up individual accounts seems to me to be pointless: they will hold government debt. Talk about political risk: some of these countries have enormous troubles collecting taxes, and what is the one thing you can surely collect taxes on? Pension accounts that the government is holding. So they may be more vulnerable to heavy taxation than any other asset. And there may be less political protection from inflation than with defined benefits (Diamond 2001).
\end{quote}

4.40 Regarding political sustainability, according to the documents we examined and, in particular, the interviews we conducted in the field, the support for the reform process has been relatively high across the full spectrum of political parties and within successive governments, which variously amended the reform, without, however, changing its basic design. The Bank’s fears about the fast political turnover were founded on principle, but in fact did not interfere with the pension-system reform. Hence, as long as the future can be inferred from past experience, it seems that the reform is not at risk of being reversed. We cannot forget, however, that some important players on the pension scene, like the unions and the Pensioner’s Federation, expressed some concerns, mainly regarding the transitional rules and protecting the poor.

4.41 Another factor that could cast some doubts on political and economic sustainability is the Constitutional Court (see Bita and Zagorski 2003, p. 44). During the past few years, the Supreme Court has been involved several times in social-protection matters. For example, in March 2001, the Court declared the link between entitlements to social insurance benefits and actual contributions unlawful. It is difficult to evaluate the consequences of such a ruling, and we have not seen the motivation for it. Yet all parties seem convinced that the reform is a positive step, and agree on the overall design. Moreover, the amendments introduced during the implementation phase can be seen as corrective measures that will not substantially hinder the expected outcome of the reform process.

4.42 Another aspect of political sustainability concerns popular support, not only considered as “happiness with the reform,” but particularly with reference to the perceived importance of old-age savings, and of the need to work in the formal sector rather than succumbing to the enticements of the informal economy. Although the results of the 1999 referendum can be interpreted as confirmation of the public’s support, our interviews showed that more attention should have been given to informing the public about the new opportunities offered by the pension reform.

\textsuperscript{22} It must be stressed that the \textit{Law on Private Pension Funds} (n. 150, June 5, 1997), establishes that “investment overseas shall not exceed 15 percent of the total value of the pension fund assets,” and the \textit{Law on State Funded Pensions} (February 28, 2000) establishes that the Commission for Finance and Capital Market Supervision may set “restrictions regarding [...] investments in deals outside Latvia.”
Finally, it is worth mentioning that two issues will need monitoring in order to avoid their becoming obstacles to the achievement of the long-run objectives of the reforms: (i) the phasing-in of the information-technology system, and the modernization of the administrative apparatus at the local level, should be given attention and resources; and (ii) continuing human capital accumulation within Latvia’s central and local administrative apparatus should be granted.

On the second issue, it must be noted that, at least to a certain extent, the Bank’s important role in capacity building was an example of what, in the long run, should be done by the universities and other institutions in charge of advanced education. Therefore, the link between the country’s demand for highly skilled personnel and the ability of the educational system to respond to this need must be strengthened. At the same time, however, the process of technological renovation of public agencies and a reinforced monitoring capacity suggest a sound government’s ability to anticipate shocks and problems. The evaluation of sustainability is summarized in table 4.5.

Table 4.5: Evaluation of Sustainability

<table>
<thead>
<tr>
<th>Item</th>
<th>Sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic sustainability</td>
<td>Substantial</td>
</tr>
<tr>
<td>Political sustainability</td>
<td>Substantial</td>
</tr>
<tr>
<td>Overall evaluation of sustainability</td>
<td>Likely</td>
</tr>
</tbody>
</table>
5. Results

5.1 Following the previous detailed evaluation of the various aspects of the Bank’s involvement in Latvia’s pension reform, we consider the following summary evaluation to be appropriate.

**Table 5.1: Evaluation of Bank Performance**

<table>
<thead>
<tr>
<th>Item</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality-at-entry</td>
<td>Highly Satisfactory</td>
</tr>
<tr>
<td>Quality-at-supervision</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Overall Bank evaluation</td>
<td>Satisfactory</td>
</tr>
</tbody>
</table>

5.2 Regarding the country’s performance, we registered an eagerness to learn, to introduce even radical changes, and to comply with international institutions’ advice. Of course, as mentioned in Chapter 3, the Bank was not the only institution acting in the country during the early years of the transition. Others players were also present, in particular, the European Union Phare and the United Nations Development Program, along with the governments of countries such as Sweden, Finland, Denmark, the United Kingdom, and the Netherlands. We are not aware of any fundamental disagreement among the various international institutions. In any case, from both the documentation and interviews, we are convinced of the dominant role played by the Bank in the area of pension reform. All of our interviews provided evidence of a high degree of cooperation between local institutions and the Bank’s representatives, and wide acknowledgement of the Bank’s role.

5.3 Accordingly, we provide the following summary evaluation of the borrower’s performance.

**Table 5.2: Evaluation of Borrower Performance**

<table>
<thead>
<tr>
<th>Item</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preparation</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Implementation</td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Compliance</td>
<td>Highly Satisfactory</td>
</tr>
<tr>
<td>Overall borrower evaluation</td>
<td>Satisfactory</td>
</tr>
</tbody>
</table>

5.4 Finally, we try to sketch a “what-if-not” scenario, which means speculating about what would have likely happened had the Bank not been involved in Latvia’s pension reform. Without resorting to pure guesswork, we are quite confident of the following conjectures. The centrality of the Bank’s role supports the hypothesis that both the pace and the quality of the reform would have been different if this important player had not participated.

5.5 Regarding the pace of reform, we think it is very reasonable to infer a much slower process in both the design and the implementation phases. The design of the new system required the rather rapid assimilation of entirely new concepts and frameworks; the implementation phase entailed rather firm management of policy instruments toward the identified objective. On the basis of our interviews, we believe that the Bank was quite essential in these respects. It is also quite easy to imagine that the reform process would have advanced through a sequence of stop-and-go, and
possibly could have been jeopardized by “second thoughts,” motivated by political
difficulties in maintaining a social consensus.

5.6 As for the “quality” of the reform, given that other institutions—in particular, the Swedish government—were involved in the reform process, it is not unrealistic to imagine that the reform of the first pillar could have taken the form of an NDC system. At the same time, the introduction of the funded pillars would have been somewhat held back.
6. Lessons Learned and an Agenda for Future Action

6.1 Two positive peculiarities characterized the Latvian case. The first is the very clear realization by Latvians of the importance not only of moving toward democracy and a market economy, but also of their actual translation into wide-ranging reforms, which, from the start, were understood to include social protection. There was an unmistakable linkage between the achievement of clearly visible progress in social and economic performance and the country’s viability, as well as continued independence. The awareness that radical, often unpalatable change was needed, and, therefore, had to be more or less unconditionally accepted, was evident across the political spectrum, the civil service, and the population, at large. None of the many administrations that succeeded each other during the 1990s disowned the reform, and in November 1999, when some of the most controversial issues were put to a referendum (as “compensation” for an earlier lack of information), the result was favorable toward reform. The debate concentrated on the speed and means of the implementation, not on the basic design.

6.2 The first lesson to be learned here is that strong political awareness of the trade-off between sacrifices and results is a crucial ingredient of any policy mix. The degree of this awareness will probably vary from country to country and outside institutions like the Bank can do little to influence the basic situation. However, they must take it into account when shaping strategies for individual countries.

6.3 The second positive peculiarity is the awareness by the civil service of the need for deep, qualitative change in the administrative apparatus, in terms of both personnel and procedures. Bureaucracies have a natural tendency to resist change, but in Latvia this tendency was superseded by the general awareness that if changes were not decisively introduced, the country’s very existence would be at risk. This made a twofold strategy possible: (i) to develop a “client-oriented” mentality in the bureaucracy; and (ii) to establish monitoring, control, and evaluation mechanisms, as well as simulation techniques, in order to be able to project the long-term consequences of demographic changes and policy measures.

6.4 The second lesson to be learned is that the bureaucracy’s acceptance of change is a variable to be taken into account in defining the Bank’s strategy in any country. Unlike general political awareness, civil service sensitivity to problems can be enhanced, at least in the upper echelons, by ad hoc Bank programs.

6.5 The result of these two factors has been the development of a highly cooperative and fruitful relationship between the Bank and Latvian officials. The Bank must be given credit for this. In a first stage, the relationship was clearly “dominated” by the Bank in what could aptly be described as a “tutorial” role; from what we could establish, Bank officials were able to play this role very light-handedly. Concepts and issues that were partially or completely new to transition economies, ranging from cost effectiveness and inter-temporal budget constraints to insurance versus redistribution, market mechanisms, and market regulations, appear to have been clearly conveyed, correctly assimilated, and ultimately incorporated into the new design for the country.
6.6 The third lesson to be learned is, therefore, nothing really new but a reconfirmed general principle: Bank programs work well when neither inferiority nor superiority complexes are developed by recipient countries.

6.7 The mix of lending and non-lending instruments has also been a critical element in the role of the Bank. The financial angle was indeed important in a country that—like most, if not all, transition countries—experienced a wide discrepancy between the demand and supply of funds; but the weight of complementary factors, such as human capital formation, should be forcefully stressed. The objective must be the blending of these instruments into a tailor-made national prescription. From what we could establish, even if it is very likely that the Bank came to Latvia with an already prepared “recipe,” it was able to blend this in with an original solution, which took into account not only national characteristics but also suggestions by the Swedish consultants to the Latvian governments.

6.8 The fourth lesson to be learned is, therefore, one of flexibility within an acceptable and sustainable general design.

6.9 The agenda for future Bank action seems to have been quite clearly defined by the May 2004 accession of Latvia to the European Union. It is reasonable to suppose that Latvia will gradually but increasingly feel the influence of European Union institutions’ issues and policies. The Bank will, therefore, have to gently relinquish its current leading role. It will, however, retain moral authority for a long time and exercise its role as a point of reference. It must also be prepared to step in swiftly, in case a sudden, improbable crisis arises. The Bank will retain the distinction of having given fundamental help to Latvia during a crucial period its history.
# Appendix A: Bank Assistance Instruments for Latvian Pension Reform

## Lending Instruments

### Country Assistance Strategy 1994–97

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Aim</th>
</tr>
</thead>
</table>
| Structural Adjustment Loan (LV-PA-44123) | 1. Development of a lower insurance coverage  
2. Creation of an independent administrative agency  
3. Development of the privately managed system  
4. Establishment of a regulatory framework |
| Latvia Public Expenditure Review | 1. Focus on shortages in the sector and suggest possible actions |

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Aim</th>
</tr>
</thead>
</table>
| Investment Loan (LV-PA-35807) | 1. Social insurance development (improving policy design, developing system administration, supporting organizational change, supporting IT)  
2. Regulation of privately managed pensions  
3. Social assistance administration reform  
4. Kandava pilot program  
5. Monitoring and evaluation of social policies (improving local skills, developing analytical capacity, starting annual social reports) |
| Technical assistance | 1. Improving public sector management and legal organization  
2. Budgeting and public investment programming  
3. Statistical reporting and forecasting  
4. Resource coordination |

## Non Lending Instruments


<table>
<thead>
<tr>
<th>Instrument</th>
<th>Aim</th>
</tr>
</thead>
</table>
| Programmatic Structural Adjustment Loan | 1. Restoring fiscal discipline and improving both allocation and technical efficiency  
2. Improving delivery of social assistance  
3. Implementing the national means-tested social assistance benefit  
4. Preparing, adopting, and implementing an action plan to place gatekeeping and referral decisions and financing responsibilities for social care and social assistance  
5. Household survey |
| The Republic of Latvia: Poverty Assessment | 1. Reporting on the main determinants of poverty in Latvia |
| Technical assistance and training | Knowledge generating and problem solving in the following fields:  
1. Social assistance  
2. Regulatory services  
3. Financial sector supervision  
4. Social insurance technical support |

## Country Assistance Strategy 2002–05

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Aim</th>
</tr>
</thead>
</table>
| Proposed Structural Adjustment Loan | 1. Reaching a cost-effective social assistance system that prevents poverty and supports the inclusion of vulnerable groups  
2. Improving the delivery of benefits |
| Country Economic Memorandum | 1. Focusing on the prospects of the economy and the overall reform |
| Public Sector Reform Review | 1. Focusing on the status of public sector reforms |
| Public Expenditure Review | 1. Advising on how to deal with the implementation problems of the MTEF |
### Appendix B: Latvia – Statistical Summary

<table>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP current prices (Russ. Rubles for 1990 and 1991, Lats after)</td>
<td>62,430,000</td>
<td>143,330,000</td>
<td>1,004,560,000</td>
<td>1,467,010,048</td>
<td>2,042,599,936</td>
<td>2,349,222,912</td>
<td>2,807,283,968</td>
<td>3,269,498,112</td>
<td>3,592,156,928</td>
<td>3,889,658,112</td>
<td>4,348,340,224</td>
<td>4,812,596,224</td>
</tr>
<tr>
<td>GDP current prices (US$)</td>
<td>12,490,000,384</td>
<td>11,025,384,448</td>
<td>6,357,974,528</td>
<td>5,315,253,760</td>
<td>5,461,496,832</td>
<td>4,904,432,128</td>
<td>5,094,889,472</td>
<td>5,627,363,328</td>
<td>6,088,401,920</td>
<td>6,684,988,160</td>
<td>7,175,478,784</td>
<td>7,663,369,216</td>
</tr>
<tr>
<td>Real GDP rate of growth</td>
<td>-1.25</td>
<td>-10.41</td>
<td>-34.86</td>
<td>-14.87</td>
<td>0.65</td>
<td>-0.81</td>
<td>3.34</td>
<td>8.38</td>
<td>4.76</td>
<td>2.84</td>
<td>0.74</td>
<td>3.95</td>
</tr>
<tr>
<td>Nominal Monthly Wage (Russ. Rubles for 1990 and 1991, Lats after), current prices</td>
<td>3,703</td>
<td>3,328</td>
<td>2,193</td>
<td>1,904</td>
<td>1,941</td>
<td>1,950</td>
<td>2,035</td>
<td>2,242</td>
<td>2,388</td>
<td>2,476</td>
<td>2,665</td>
<td>2,893</td>
</tr>
<tr>
<td>Nominal Monthly Wage (US$), current prices</td>
<td>62,430,000</td>
<td>143,330,000</td>
<td>1,004,560,000</td>
<td>1,467,010,048</td>
<td>2,042,599,936</td>
<td>2,349,222,912</td>
<td>2,807,283,968</td>
<td>3,269,498,112</td>
<td>3,592,156,928</td>
<td>3,889,658,112</td>
<td>4,348,340,224</td>
<td>4,812,596,224</td>
</tr>
<tr>
<td>GDP per capita (constant, 1995 US$)</td>
<td>562,430,000</td>
<td>143,330,000</td>
<td>1,004,560,000</td>
<td>1,467,010,048</td>
<td>2,042,599,936</td>
<td>2,349,222,912</td>
<td>2,807,283,968</td>
<td>3,269,498,112</td>
<td>3,592,156,928</td>
<td>3,889,658,112</td>
<td>4,348,340,224</td>
<td>4,812,596,224</td>
</tr>
<tr>
<td>Life expectancy at birth M</td>
<td>64.20</td>
<td>63.80</td>
<td>63.30</td>
<td>61.60</td>
<td>60.70</td>
<td>60.80</td>
<td>63.30</td>
<td>64.20</td>
<td>64.10</td>
<td>64.90</td>
<td>64.97</td>
<td>65.03</td>
</tr>
<tr>
<td>Life expectancy at birth F</td>
<td>74.60</td>
<td>74.80</td>
<td>74.80</td>
<td>73.80</td>
<td>72.90</td>
<td>72.00</td>
<td>75.70</td>
<td>75.90</td>
<td>75.50</td>
<td>76.20</td>
<td>76.13</td>
<td>76.07</td>
</tr>
<tr>
<td>Life expectancy at birth</td>
<td>69.27</td>
<td>69.17</td>
<td>68.91</td>
<td>67.35</td>
<td>66.65</td>
<td>66.80</td>
<td>69.35</td>
<td>69.91</td>
<td>69.66</td>
<td>70.41</td>
<td>70.41</td>
<td>70.42</td>
</tr>
<tr>
<td>Fertility rate</td>
<td>2.02</td>
<td>1.86</td>
<td>1.73</td>
<td>1.51</td>
<td>1.39</td>
<td>1.25</td>
<td>1.16</td>
<td>1.11</td>
<td>1.09</td>
<td>1.16</td>
<td>1.16</td>
<td>1.16</td>
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<tr>
<td>Pension statistics (current prices)</td>
<td></td>
<td></td>
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<td></td>
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<td></td>
<td></td>
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<tr>
<td>System dependency ratio</td>
<td>0.4</td>
<td>0.5</td>
<td>0.5</td>
<td>0.6</td>
<td>0.6</td>
<td>0.7</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
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</tr>
<tr>
<td>Old - age pensioners (thousands)</td>
<td>412</td>
<td>498</td>
<td>497</td>
<td>500</td>
<td>496</td>
<td>497</td>
<td>504</td>
<td>511</td>
<td>513</td>
<td>514</td>
<td>514</td>
<td>514</td>
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<tr>
<td>Disability pensioners (thousands)</td>
<td>61</td>
<td>87</td>
<td>102</td>
<td>104</td>
<td>103</td>
<td>99</td>
<td>95</td>
<td>90</td>
<td>86</td>
<td>83</td>
<td>81</td>
<td>81</td>
</tr>
<tr>
<td>Survivor pensioners (thousands)</td>
<td>30</td>
<td>32</td>
<td>28</td>
<td>26</td>
<td>29</td>
<td>38</td>
<td>39</td>
<td>37</td>
<td>37</td>
<td>36</td>
<td>37</td>
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<tr>
<td>Old age benefit (US$)</td>
<td>48.8</td>
<td>48.8</td>
<td>48.8</td>
<td>48.8</td>
<td>48.8</td>
<td>48.8</td>
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<td>48.8</td>
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</tr>
<tr>
<td>Disability benefit (US$)</td>
<td>30.0</td>
<td>30.0</td>
<td>30.0</td>
<td>30.0</td>
<td>30.0</td>
<td>30.0</td>
<td>30.0</td>
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<td>30.0</td>
<td>30.0</td>
<td>30.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Survivor's benefit (US$)</td>
<td>28.0</td>
<td>28.0</td>
<td>28.0</td>
<td>28.0</td>
<td>28.0</td>
<td>28.0</td>
<td>28.0</td>
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<td>28.0</td>
<td>28.0</td>
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</tr>
<tr>
<td>Average pension (US$)1</td>
<td>55.2</td>
<td>55.2</td>
<td>55.2</td>
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<td>55.2</td>
</tr>
<tr>
<td>Pensions payments (thousands US$)</td>
<td>11,591,1</td>
<td>110,141,2</td>
<td>355,991,3</td>
<td>461,786,5</td>
<td>542,800,1</td>
<td>588,864,3</td>
<td>682,644,9</td>
<td>786,767,2</td>
<td>786,767,2</td>
<td>786,767,2</td>
<td>786,767,2</td>
<td>786,767,2</td>
</tr>
<tr>
<td>Ratio average pension/average net-wage</td>
<td>34.3</td>
<td>34.3</td>
<td>34.3</td>
<td>34.3</td>
<td>34.3</td>
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<td>34.3</td>
<td>34.3</td>
<td>34.3</td>
</tr>
<tr>
<td>Replacement rate (from average gross wage)</td>
<td>29.8</td>
<td>29.8</td>
<td>29.8</td>
<td>29.8</td>
<td>29.8</td>
<td>29.8</td>
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<td>29.8</td>
</tr>
</tbody>
</table>


Note that the local currency for 1990 and 1991 is still the Russian ruble, moreover for some of the early years after independence exchange rates appear to be unreliable; blank cells mark unavailable data.

1 For 1992, 1993, 1994, estimates from "Pension Reform in the Baltics".

2 The used exchange rate is the one provided by the Ufficio Italiano Cambi; according to "Pension Reform in the Baltics", however, the US$ conversion delivers 15.5 US$ instead of 8.2 US$.

3 The used exchange rate is, again, the one provided by the Ufficio Italiano Cambi, and "Pension Reform in the Baltics", again, suggests a different conversion: US$ 11.3, instead of 1.5.
Appendix C: Interviews  (in alphabetical order)

Mr. Vilnis Adamsons  Associate Professor, University of Latvia
Mr. Ingus Alliks  Deputy Secretary of State, Ministry of Welfare
Mr. Egils Baldzens  Free Trade Union Confederation of Latvia
Ms. Sandra Baltina  Director, Social Assistance Department, Ministry of Welfare
Mr. Janis Bokans  Supervisor at the State Social Supervision Inspectorate (up until 2000)
Ms. Dace Brencena  Executive Director, Unipensija PPF
Mr. Oskars Briedis  Deputy Director, State Funded Pension Assets Management Department, State Treasury
Mr. Uldis Cerps  Chairman, Financial and Capital Market Commission
Mrs. Inguna Dobraja  Chief of the Latvia Office, World Bank
Mrs. Agrita Groza  Deputy Secretary of State, Ministry of Welfare
Mrs. Ieva Jaunzeme  Employers’ Confederation
Mrs. Lucija Kavale  University of Latvia
Mr. Ivars Kirsons  Consultant on State Pension Funds
Mr. Peteris Krigeris  Free Trade Union Confederation of Latvia
Ms. Elita Krumina  Welfare Sector, Financing Division, Ministry of Finance
Mr. Vladimirs Makarovs  Former Minister of Welfare
Mrs. Maija Porsnova  Former State Secretary, Ministry of Welfare
Mr. Ilmars Rimsevics  Governor, Bank of Latvia
Mrs. Silvija Simfa  Advisor, Social Sector, Local Municipalities Union
Ms. Inese Smitina  Director General, State Social Insurance Agency
Mrs. Inta Vanovska  Head of Pension Policy Division, SID, Ministry of Welfare
Mr. Edmunds Vaskis  Director, Social Statistics Department, Central Statistical Bureau of Latvia
Mrs. Lilita Velde  Director, Social Insurance Department, Ministry of Welfare
Mrs. Aina Verze  Pensioners Federation
Ms. Laima Zilite  Second Tier Department, SSIA
Mrs. Rudite Zvirgzdina  Private Pension Fund Association; Chairman, Lattelekom & Latvenergo PPF
References


__________. 2002c. Law on Social Services and Social Assistance.


