

Study on the Social Protection Systems in the 13 Applicant Countries

Latvia Country Study



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Social Protection in Latvia

1. INTRODUCTION: ECONOMIC, FINANCIAL, SOCIAL AND DEMOGRAPHIC BACKGROUND

1.1 Main influencing factors for social protection

1.1.1 Economic and financial indicators

During the past five years the economic development was successful in Latvia, with continuous growth of GDP. From 1996 until the first half of 1998, the average growth rate of GDP was 6% due the rapid development in manufacturing industry, where the output increased by 31% in the same time span. As in many other countries, from the second half of 1998 and in 1999 the economy of Latvia was affected by the crisis in economy of Russia. The impact of it resulted in decreased export of goods, some commercial banks experienced difficulties, the revenues of state budget were not as high as planned, the unemployment rose in 1999 to the highest rate in all years after regaining independence. For the first time since 1995, state social insurance budget closed the year 1999 with a fiscal deficit of Latvian Lats (LVL) 57.6 mln. As a result, revenues were insufficient to ensure the payment of benefits, whereas the increase in expenditure was affected by generous amendments made to the law „On State Pensions“ two weeks before the parliamentary elections held in October 1998. Sources for financing the deficit were funds still at disposal at the beginning of the year (LVL 20.2 mln.) and a loan from the basic state budget (LVL 37.3 mln).

Nevertheless, the fall in productivity in industry and agriculture was compensated by high level of activities in construction and several branches of services. The industrial output continued to grow in branches of industry, which were oriented to Western markets: manufacture of wood and products of wood, manufacture of metal products and manufacture of wearing apparel. Thus the GDP continued to grow in years 1998 and 1999, however the growth rate was modest - 3.9 and 1.1 correspondingly. In 2000, GDP growth was 6.6%, witnessing that Latvia has overcome the difficulties caused by unfavourable internal conditions. The development of national economy in 2001 was even more successful. The stable growth was in manufacture of wood, metal products, textiles, construction. Especially rapid growth was seen in all branches of services - by 9.6% in the first half of 2001, in transport and communications - by 14.0%. Growth in domestic and foreign trade and domestic money supply had a positive impact on the development of economy: the time deposits of enterprises and private

persons in LVL. Foreign investment during the past five years was growing in average by 18.8%, in year 2000 - by 22%.

The positive tendencies in economy resulted in growth of GDP - in 2001 the growth rate was 7.6% (*data of the Central Statistical Bureau of Latvia*). In the GDP per capita there are significant regional differences. For example, in the Riga region it is twice as high as in the Latgale region (eastern part of country).

In the period from 1996 to 2001, the inflation rate was low, largely due to the anti-inflationary measures (tight monetary and fiscal policies). The exchange rate of national currency LVL, was stable.

The European Commission has provided positive evaluation of economic development of Latvia. In the annual Progress Report published on November 13, 2001 the Commission concludes that there is a functioning market economy in Latvia. It is said that Latvia has preserved macroeconomic stability and already in the nearest future should be able to cope with the competitive pressure and market forces in the EU market.

Despite the positive trends in economic development, the funding for almost all areas of the welfare sector in 2000 has decreased in absolute figures as well as against GDP. Funding allocated for health care that has been even more reduced in 2000 and 2001 gives rise to particular concern. Due to a shortage of resources, sickness funds are unable to pay medical institutions for services provided. By the end of 2001, some hospitals refused to treat patients, except the cases of emergency. Until now, there is no answer who will repay the debts to pharmacies for the medicinal products eligible for reimbursement. Those expenses have to be covered by sickness funds.

The total revenues in the social insurance special budget in 2001 were LVL 489.5 mln and total expenditures LVL 498.7 mln. Thus the state social insurance budget ended the year 2001 with a fiscal deficit of LVL 9.2 million (LVL 29.2 in the year 2000). Despite the decreasing budgetary deficit, the situation in the state social insurance budget is worsening. Each year, beginning from 1999 the deficit is covered by the loans from the state basic budget. If in many European countries state budget covers any deficit in social insurance budget, in Latvia it is covered by loans with high interest rate: 9,32% in year 2000; 8,28% in year 2001. At the same time, the State Revenue Service is responsible for social insurance contributions collection.

On 31 December 2001, total arrears of social insurance contributions were LVL 116.5 million.

Alongside with the general positive development of economy there still are some negative factors such as informal market, shadow economy, corruption. Many of the employers apparently engage in tax and social

insurance contributions minimising by purposely underestimating and hiding the real value of employee's income.

The Central Statistical Bureau of Latvia is trying to estimate the impact of the informal market and shadow economy on the development of economy. If taking in account those sectors, the growth rate of GDP is higher.

Latvia's unofficial economy has been estimated to be approximately 35% of the official economy in 1995 (see Simon Johnson, Daniel Kaufman and Andrei Shleifer, "The Unofficial Economy in Transition," *Brookings Papers on Economic Activity* 2: 1997.159 -239). The situation has not changed significantly over the following years. In the newest publication in a Latvian journal on economic issues the estimate of independent experts is given that the shadow economy in Latvia amounts to 30 -50% of GDP (Guntis Rozenbergs, *Kapitāls*, nr.3(51) 2002, 03.). The potential benefits of operating unofficially are significant. Enterprises estimate that their unofficial competitors earn a 60% increase in profits by not paying taxes, not getting appropriate licenses and registrations, and so on. In highly competitive sectors where the margins are slim, the smaller costs of unofficial enterprises allow them to set prices well below their law-abiding competitors. The evolutionary effect is to drive honest competitors from the market, or drive them toward illegality.

The underground economy and corruption go hand-in-hand. The Corruption Perceptions Index issued by Transparency International in 1999 ranked Latvia in 58th place. Officials who have the discretion to either report the enterprise or turn a blind eye can either cost or save the enterprise a lot of money.

In the framework of a survey conducted by the World Bank in 1998, enterprises were asked a hypothetical question: how much more as a percentage of revenues would you be willing to pay in taxes if all corruption were eliminated? 70% of enterprises said „zero“, a clear testament that while corruption may be widespread, many enterprises have learned how to work within the system and even benefit from corrupt activities.

In year 2000 the NGO *Delna* carried out a study named *The Face of Corruption in Latvia*. The results of this survey reflect the public belief in widespread corruption. The most corrupt and dishonest institutions are believed to be customs service, the traffic police, the communications company *Lattelekom*, Privatisations Agency, the State Real Estate Agency and the courts.

1.1.2 Demographic indicators

In Latvia the demographic situation over recent years has been unfavourable as, since 1991, the natural growth of the population has been negative - more people die than are born. The most negative increase was recorded in

1994, when the number of deaths exceeded the number of births by 17 500. The uninterrupted succession of generations is not ensured and, in years to come, the population of Latvia is expected to continue to age.

Economic changes have resulted in a rapid fall in living standards for most of the population in Latvia and have also stimulated a decrease in the number of children in the family and decline in the birth rate in the country. During the the period 1990 - 1999, the births declined from 37 918 to 19 396, i.e. almost by a half, while the deaths remained unchanged - slightly more than 33 000 per year.

The decline of births is influenced by the number of terminated pregnancies which is very high in Latvia (*see also chapter 1.1.3. - Family structure*).

During the period between two censuses, from 1989 until 2000, the population in the age group 0 - 14 decreased by 26% while the number of population in the age group 15 - 59 decreased by 11%. The number of population over 60 years has grown by 9%.

Another indicator reflecting the demographic situation and public health is the average life expectancy which, in Latvia, is low in comparison with other European countries. Along with the decline in the birth rate under the impact of social and economic changes, by the middle of the nineties the number of deaths caused by, for example, external factors, such as suicides, alcoholic intoxication, traffic accidents and murder, has increased dramatically in Latvia.

The difference in life expectancy of men and women is particularly great. During the last ten years, the average projected life expectancy of male neonates has been constantly at least 10 years less than that of female neonates. The situation is aggravated by such unfavourable factors as alcoholism and unnatural death. During the last five years, men have been diagnosed as suffering from alcoholism as much as five times more often than women. In its turn, the number of unnatural deaths among men for the same period has been fifty percent higher than among women.

It must be noted that average life expectancy also has territorial characteristics: in rural areas the life expectancy of both genders is lower than in urban areas - by one year for women and up to three years for men.

The decrease of population is caused by emigration exceeding immigration too. External long-term migration by ethnic nationality has changed over last three years. If in 1995 there were more Latvians coming back to Latvia (exile Latvians), in year 2000 the number of Latvians leaving the country exceeded the number of immigrants. The number of Russians leaving the country is growing: 10 468 in 1995, 1 930 - in 2000. The number of emigrating Belarussians in the same time span has decreased

from 1 289 to 254. The same trend is characteristic for Ukrainians. The migration of other nationalities is unsubstantial.

The emigration to Commonwealth of Independent States (former USSR) is more characteristic for elderly cohorts, for younger cohorts mainly emigration to Western countries can be observed.

National internal migration is characterized by movement of the rural population to towns.

Table 1.1: Migration balance (including internal migration)

	1996	1997	1998	1999	2000	2001
Immigration	42 112	42 132	41 852	38 796	36 616	
As % of population	1.71	1.72	1.73	1.62	1.54	
Emigration	52 308	51 648	47 700	42 971	38 462	
As % of population	2.12	2.11	1.97	1.79	1.62	
Net migration	-10 196	-9 516	-5 848	-4 175	-1 846	
As % of population	0.41	0.38	0.24	0.17	0.08	

Source: Statistical Yearbook of Latvia 2001

1.1.3 Social indicators

The difference in unemployment rate (see Table 12 in Annex) is due to the national definition of unemployment. According to the Law „On Employment“ there are two definitions relevant for measuring unemployment: the “job-seeker” and the “unemployed”. Job-seekers are all persons (both registered and non-registered with the State Employment Service) of working age who do not work and are not temporarily absent from work, are actively seeking a job and immediately available for work if they find it. The number of job seekers is calculated according to ILO methodology and corresponds to Eurostat unemployment rate.

The unemployed are job-seekers of working age (from the age of 15 to retirement age) who are registered with the State Employment Service.

Employment guidelines in the National Employment Plan (NEP) are contained under four headings: improvement of the capacity for work, the development of businesses, stimulation of the adaptability of enterprises and their employees and the implementation of the policy of equal opportunities for men and women.

In comparison with 1999, in 2000 the number of employees grew in the sector of financial mediation, reaching 26.9%. The trend which had been observed over recent years for the ratio of employees working in the area of

services to increase persisted. In November 2000, their ratio was 60.1%. However, there had been a considerable decrease in the number of employees in such industries as agriculture, hunting and forestry (by 12.7%), fishing (by 47.75%), public administration and defence, and compulsory state social insurance (by 9.1%). These changes show that the restructuring of the economy continues.

The highest demand on the labour market is for qualified workers and craftsmen and for specialists but the most extensive supply is of representatives of unqualified professions.

The minimum monthly salary was raised from LVL 50 to LVL 60 at 1 July 2001 and constitutes 69.02% of the average subsistence minimum in 2001.

According to the data of the Central Statistical Bureau, over recent years the nominal growth rate of salaries has tended to slow down. In comparison with 1999, in 2000 the increase is 6.1% while four years ago the rate of increase in salaries was 20% on average. The comparison of the public sector and the private sector allows us to conclude that the rate of increase of salaries in the private sector is slower than in the public sector. In 2000, the salary for one fifth of all employees was calculated within the range of LVL 100 to LVL 150 per month. However the salary calculated for almost half of employees did not exceed LVL 100 per month. In 2000, the monthly average gross salary in the public sector was LVL 160.03 while in the private sector it was LVL 135.96. At the same time the upper limit of salaries from which social insurance contributions are deducted was set by 15 000 LVL per year. It means that in year 2000 there were 1 364 employees, whose monthly salary exceeded LVL 1 250 per month.

Many employees in the private sector are employed without employment contracts or employees are paid minimum monthly salary officially, the rest of their salary being 'handed out in envelopes'.

As it was mentioned above, the creation of equal opportunities for men and women is one of the guidelines in the employment policy. For the time being, there is a discrepancy between the formulated goals and the reality.

Women are affected by unequal opportunities in the labour market. The average gross earnings of women are lower than those of man in all professions. In average, the earnings of woman were 76.7% in 1997, 78.1% in 1998, 78.5% in 1999, 80% in 2001 of those of men.

Women more frequently are employed in professions with low prestige.

However, taking into account current trends and policy developments relating to gender issues, one can speak about progress.

As a result of structural changes in the national sectors of the economy, female employment in recent years has increased by 3.3% (from 1997 to 2001), approaching the average EU rate.

Moreover, there is a tendency of female employment to grow and male employment to decline, mostly due to structural changes (the situation was quite different during the Russian economic crises which influenced food and textile industries.)

The ratio of the unemployed in the age group over 55 increased by 14% in 2000. It is mostly related to the increase of unemployment among women caused by raising of the retirement age.

Nevertheless, the share of women in job seekers (*unemployed - according the ILO methodology*) is lower than that of the man.

Although the average number of persons employed has not essentially changed in the last years the number of job seekers goes down. Persons with higher education have the lowest rate of job seekers: in year 2001 6.3% for men and 5.4% for women. The highest rate is among persons with incomplete basic education: 27.4% for men and 16.9% for women.

There are significant regional differences in the unemployment rate in the country. At the end of 2000, the lowest unemployment level was in Riga, and the Ogre and Saldus districts (3.7%, 5.3% and 6.5% respectively). The unemployment level in the Latgale region still remained considerably higher than the national average : in Rezekne, Balvi, Kraslava and Preili districts (25.6%, 21.8% and 20.1% respectively). *This unemployment rate is given according to national definition of unemployment.*

Income distribution, poverty.

The GDP per capita has been relatively low during the last five years. According to Eurostat data, the GDP per capita in Purchasing Power Standards (PPS) in 2000 in Latvia was only 29% of the average of European Union.

According to the human development index by UNDP, Latvia was ranked 50th in the world in 2001 (92nd in 1998; 74th in 1999; 63rd in 2000) in terms of population's living standard

Studies of household budgets by the Central Statistical Bureau show that since 1996, the monthly income per household member has increased steadily. In comparison with 1999, in 2000 the average monthly household disposable income per capita has increased from LVL 64.73 to LVL 69.19 (by 6.8%). The value of minimum consumer basket of goods and services in those years was correspondingly LVL 83 and LVL 84. In 2000, the average

income per household member in the poorest quintile (the first quintile) has decreased by LVL 1.49 (5.9%) in comparison with 1999. The inequality of income distribution among the population is increasing each year. The Gini coefficient in Latvia has increased steadily over the past five years. In 1997 it was 0.31, in 1998 - 0.32, in 1999 - 0.33 and in 2000 - 0.34. According to household budget survey results, the wealthiest have incomes up to 100 times larger than the very poorest.

While absolute poverty implies a situation characterised by lack of basic necessities such as food, clean drinking water, sanitation, health, education and information, relative poverty focuses on income. What characterises persons exposed to relative poverty is that their income prevents them from rising above the poverty line. In the author's point of view, both forms of poverty constitute a serious problem in Latvia.

The study of poverty has become a major concern only during the last 4 years, when based on the data of the Household Budget Survey, some selected poverty indicators were calculated. In 1998, the Ministry of Welfare, in co-operation with UNDP, World Bank, ILO, the University of Maastricht, Latvian Institute of Philosophy and Sociology and the Central Statistical Bureau of Latvia, conducted several research projects on poverty. Based on the findings of these researches, a strategy for reduction of poverty in Latvia was worked out.

There is no official poverty line in Latvia. The government calculates a so-called „crisis subsistence minimum“ set by the Government in the amount of - 38.23 LVL per month in 1994 – remains unchanged until now. A person is recognised as „poor“ and as such entitled to social assistance benefits if his/her income does not exceed 75% of „crisis“ minimum, i.e. 28.67 LVL (for more details see chapter 4).

The most vulnerable groups are families with three and more children and households with one adult and two or more children.

When calculating poverty risk for different socio-demographic groups, conclusion has been made that poverty in Latvia has a considerable gender dimension.

This poverty risk is higher throughout the life cycle. The average wage of women is substantially lower than that of men, they have more erratic employment records and correspondingly, the average pensions are lower.

Men are also affected by poverty, but the characteristic of poverty risk for them is different. On one hand, men are not affected by some of the risks haunting women, e.g. discrimination of single mothers on the labour market, and are generally better paid and have easier access to high-quality jobs. The household income survey shows that households where a man is the main breadwinner are generally better off than households with a female head. On

the other hand, men are characterised by a much lower health standard (invalidity incidence, average life expectancy), which implies labour market risks related to reduced earning capacity, risk of survivorship for dependants and growing number of households with a widowed female breadwinner. The latter, of course, brings us back to the poverty risk of households with a female breadwinner. (for more details on poverty and social inclusion in Latvia see chapter 4).

There are no reliable data on the number of children per family. Fertility rate of women could be taken as an indicator.

The divorce indicators in Latvia are among the highest in Europe. The divorce intensity has, however, decreased over the past years. Both the absolute and relative indicators have decreased. Nevertheless, taking into account the low intensity of marrying, the rate of divorces still exceeds 60% of the number of registered marriages.

The number of underage children in divorced families is increasing. In the year 1999 of all dissolved marriages, 67% were families with underage children. The child dependency ratio is decreasing. Due to the small number of children in the families, the exchange of generations is guaranteed only by 60%.

The number of terminated pregnancies, which is very high in Latvia, also influences the birth rate. In 1999, 18 031 abortions were performed, which is 30 abortions per 1000 women at the fertile age. However it must be noted that since 1991 the number has decreased almost by half - from 44 886 in 1991 to 22 974 in 1999, and the trend continues.

One of the reasons affecting the fertility rate is the declining number of females in the fertile age (15 - 49), especially in the age group 20 - 29, which has the highest fertility rates. During the last 10 years the number of females in the age group 20 - 29 decreased by 25.9 thousand and the percentage of this age group in the total number of females in the fertile age fell from 29.3% to 27.2%.

Until the compilation of the 2000 Population Census data, there is no precise information on the number of one-parent families. The data of the Living Conditions Survey, which was conducted in October 1999, shed some light on the problem. According to this survey, one-parent families represented 7.1% of the total number of households in country. The majority of them had only one child but one-parent families with 2 and more children constituted 2.2% of all households. According to the following survey, conducted in the year 2000, one-parent families represented 4.5% of the total number of households.

The same survey shows that single households represented 32.7 % of the total number of households in the year 2000.

1.2 How does the described background affect social protection?

1.2.1 Forecasts and projections

The overall trend for Latvia's economy is for the continued growth of industrial output to be concentrated in labour - intensive branches with low added value (foodstuffs, forestry, wood processing, construction, clothing manufacture and services). From a human development perspective, this trend is positive in the short term, as it creates jobs. The goal of the government for the next years is to ensure GDP growth at 5 - 7% per year. To achieve this, it is planned to continue strengthening the macroeconomic environment as a precondition for growth, to maintain a stable exchange rate of the LVL, keeping inflation at the rate 2-4% per year and gradually bringing down the fiscal deficit of the State budget and improving the balance of the current account. Despite the difficult situation in the social insurance budget, the forecast is that the deficit (with the accumulated negative reserve) will end by 2007- 2010.

In the author's opinion, those forecasts are optimistic. The Ministry of Economy has developed two scenarios of medium term (until 2007) development - the slow scenario (Version I) of development with limited possibility to increase exports and the dynamic scenario (Version II), when growth of exports will become the main source of increase of GDP.

Table 1.2: Forecast of GDP growth (in %):

	2002	2003	2004	2005	2006	2007
Version I	4.0	5.0	5.0	5.0	5.0	5.0
Version II	6.0	7.0	7.0	6.0	6.0	6.0

The Institute of Economy of Academy of Sciences regards those forecasts as "a fraction too high for a cautious planning document, yet realistic". Until now, Latvia has not experienced an impact of the global economic slow-down, which is clearly seen in the European Union. Still, growth in 2002 is anticipated to be slower than in 2001. According to the Institute, Latvia will severe the approaching crisis easier if it succeeds in finding its own niche in the global system.

On July 17, 2001 the Cabinet of Ministers approved the Long Term Economic Strategy of Latvia. The strategy identifies the goal to achieve the level of welfare of people matching standards of the developed countries in the nearest future as the main task of state economic policy. A more specific objective is to reach the average per capita GDP level of the EU member states (the present 15 EU member states) within the next 20 - 30 years.

To achieve this goal, Latvia should put an end to the currently dominating economic model, characterised by the use of cheap labour and the available

natural resources. Taking into consideration the limited natural resources, low capacities of the economy and the small market, as well as unfavourable demographic conditions, the most sustainable way of developing national economy able to ensure the needed GDP growth is intensive use of knowledge and high technologies, reorientation from labour-intensive economy to knowledge-intensive economy. In the long run, Latvia's interests lie in the development of high technology branches with high added value and great export potential.

The task to create a competitive economy may not be reached without a favourable environment for business. Competitiveness of the economy will be determined by the level of competitiveness of tax policy, efficiency of the capital market, infrastructure, the education system and the degree of state support. With the aim to create better environment for business (especially for foreign investment), the social insurance contributions rate has been reduced gradually: starting with the rate 38% (37% -employer; 1% - employee) and ending with the rate 33% (17.4% - employer; 16.5% - employee) in January 1, 2003. In years 2001 and 2002 the rate is divided between employer and employee: 26.06% and 9% of gross earnings correspondingly. The next reduction is prescribed by law, but this question is included by trade unions in the agenda of the National Tripartite Council. Until now social partners have not reached an agreement.

As described in 1.1.2, the demographic processes in Latvia are developing in a very ill-shaped way and Latvia is facing an increasing depopulation. Although the ethnic Latvians' record of self-reproduction is better than national average, it makes up only two thirds of that needed for simple reproduction. The situation analysis and calculations show that the demographic processes are not to change substantially in years to come. Depopulation is going to remain, and the number of Latvia's inhabitants, as well as ethnic Latvians, to decrease. If in 2001 the demographic burden was 380 persons of retirement age per 1000 inhabitants of working age, the calculations show that in 2040 - 2050 the demographic burden will be 500, i.e. two contributors to social insurance system will provide a pension for one pensioner. And this prognosis is made assuming that all inhabitants of working age will be employed and paying contributions.

According to the forecasts, the unemployment level in the next years will remain fairly stable, although further activation of employment measures could possibly lead to a minor reduction of the unemployment rate. As far as the author has inquired, no labour market development modelling has been carried out, apart from the general forecasts already described under 1.2.1.

In the labour market policy, following areas remain topical for the next years: the enhancement of the quality of the labour force, the promotion of employment among young people, the reduction in the length of unemployment, the formulation of special employment programmes for the integration of the unemployed of pre-retirement age into the labour market.

The last measures are relevant in the demographic context and taking in account the rise in retirement age. Furthermore, in the year 2005 the possibility for early retirement will be abolished.

1.2.2 Influences of economic, demographic and social developments on the social protection system

During the past five years, Latvia has achieved macroeconomic stabilisation, and preconditions for continued growth have been established. The business environment is gradually improving and progress has been achieved in privatisation. However, these positive development trends in the national economy have failed to significantly improve the prosperity and living conditions of the population.

One of the main problems resulting from demographic trends is related to the funding of the social protection system. With the number of retirees growing and the number of population of working age simultaneously declining, the number of people paying compulsory social insurance contributions also declines. Meanwhile increasingly more resources are required for people past working age - for health care, social assistance and social insurance.

Great expectations to improve the financial situation were linked to the pension reform. The state social insurance pension formula contains a component (as divider) which depends on the demographic situation in the country: the forecasted life expectancy at of the moment of retirement. The longer contributions are paid and the later the pension is required, the higher the annual pension will be. Thus a financial incentive to postpone the retirement was introduced. Still the practice of five years (1996 - 2001) after reform has shown that the possibility to postpone the retirement is used on rare occasions and does not effect the real retirement age significantly.

From 1 July 2001, the second pillar, the mandatory funded pension scheme is implemented. The necessity of a funded pension scheme was justified with the demographic prognosis, and the time of implementation of the scheme has also been chosen with regard to the demographic situation: in these years, the retirement age reaches the generation born during the 2nd World War, when the birth rate was low. In turn, the generation born in 1980-ties, when the birth rate was two times higher than today, enters the labour market. This process is reflected in the dynamics of the newly granted pensions: in year 2000, the newly granted pensions constituted only 39.09 % compared to the number in the year 1999.

This trend is expected to last until 2010 - 2012. After that the demographic situation will worsen considerably.

As described above, poverty is a real problem in Latvia. Under the conditions of permanent poverty, value orientation of the low - income segment of society has undergone profound changes..

As a result of the changes in the economic situation over the last decade, a large number of families with children find themselves in the most difficult situation. There is, naturally, no doubt that many poor families make great sacrifices in order to give their children the best start in life. However, this does not change the statistical facts that show that children who grow up in poverty more often have problems with regard to a proper education, abuse, criminal activity and unemployment.

That in itself is a problem. The biggest problem is, however, that poverty and the disadvantages of poverty among these children are carried on to the following generations. Poor children run a greater risk of becoming poor adults. This is substantiated by surveys which show that poverty experienced in childhood reduces the expected earnings of adults by 30 percentage points on average (*see Karen Sejersdal Christensen „Poverty politics and children“, ISSA, Reports presented at the 27th General Assembly of the ISSA*).

1.3 Annex to chapter 1

Table 1.3: Gross Domestic Product

GDP	1996	1997	1998	1999	2000	2001		
Absolute in 1000 mln EUR	4.0	5.0	5.4	6.2	7.8			
Annual growth rate	3.3	8.6	3.9	1.1	6.6	Q1 8.3	Q2 9.2	Q3 6.3
Per head in PPS	4800	5400	5700	6100	6700			

Source: Statistics in focus, Economy and Finance, Eurostat, Theme 2/ - 42 2001 and Theme 2 - 5/2002.

Table 1.4: Annual inflation rate (increase from previous year, %)

	1996	1997	1998	1999	2000	2001
Inflation (%)	17.6	8.4	4.7	2.4	2.6	2.5

Source: Data of Central Statistical Bureau of Latvia

Table 1.5: Social expenditure as percentage of GDP

	1996	1997	1998	1999	2000
Social insurance	11.3	11.9	11.4	12.3	11.4
Social assistance	1.9	2.0	1.8	1.9	1.9
Health-care	4.2	3.7	3.7	3.8	3.5
Employment	0.5	0.5	0.8	1.2	1.0
Total	17.5	17.9	17.6	19.3	17.8

Source: data of the Ministry of Finance, calculations of the Ministry of Welfare (private social expenditure not included).

Table 1.6: Public social expenditure as % of state consolidated budget

	1996	1997	1998	1999	2000	2001
Social insurance	34.8	32.0	33.1	35.2	34.2	32.9
- pensions	26.5	25.5	26.2	27.6	27.2	26.3
- maternity and sickness	1.7	0.5	0.7	0.9	0.9	1.0
- disability	5.3	4.7	4.6	4.3	4.1	3.9
- unemployment	1.3	1.3	1.5	2.4	1.9	1.6
Social assistance	4.5	4.2	4.1	4.0	4.2	4.0
Health-care	12.7	11.3	10.9	10.4	10.3	10.7
Employment	0.3	0.3	0.3	0.3	0.4	0.5
Total	52.3	47.7	48.3	49.9	49.0	48.0

Source: data of the Ministry of Finance, calculations of the Ministry of Welfare

Table 1.7: Male/female population

	1996	1997	1998	1999	2000	2001
Male	1 158.5	1 148.2	1 138.5	1 130.0	1 122.9	
Female	1 343.2	1 331.7	1 319.9	1 309.4	1 301.3	

Source: Eurostat

Table 1.8: Age structure(%)

	1995	1996	1997	1998	1999	2000	2001
Less than 15 years	20.7	20.3	19.3	19.3	18.5	17.3	
45- 65 years	24.1	24.0	23.9	23.9	24.0	24.7	
More than 65 years	13.4	13.7	14.0	14.3	14.4	15.2	

Source: Eurostat

Table 1.9: Demographic dependency ratio, net population increase

	1995	1996	1997	1998	1999	2000	2001
Dependency ratio (total)	736	732	726	695	699	658	
Under working age (> 15)	353	344	332	314	303	286	
Over working age	383	388	394	381	396	372	
Net increase*	- 11.1	-8.7	-8.7	-7.7	-6.3		

Sources: *Eurostat Dependency ratio demographic burden per 1000 inhabitants of working age. Data of Ministry of Welfare, calculated each year taking in account the rise of retirement age.

Table 1.10: Fertility: birth rate per 1000 inhabitants, fertility rate, net reproduction rate

	1995	1996	1997	1998	1999	2000	2001
Birth rate	8.6	7.9	7.6	7.5	8.0	8.5	
Fertility rate	1.3	1.2	1.1	1.1	1.15	1.24	
Reproduction rate	0.58	0.54	0.52	0.52	0.56	0.59	

Source: Eurostat

Table 1.11: Life expectancy

Male	1995	1996	1997	1998	1999	2000	2001
At birth	60.8	63.9	64.2	63.8	64.9	65.0	
At age 65	11.7	11.9	11.4	11.3	11.3	12.6	

Female	1995	1996	1997	1998	1999	2000	2001
At birth	73.1	75.6	75.9	74.9	76.2	76.1	
At age 65	15.8	17.6	17.6	17.3	17.8	16.9	

Source: Eurostat

Table 1.12: Unemployment rate

	1995	1996	1997	1998	1999	2000	2001
Eurostat	18.9	18.3	14.4	13.8	14.5	14.4	
CSB*		7.1	6.7	8.8	9.1	7.8	

* Data of Central Statistical Bureau (CSB) of Latvia and State Employment Service

Table 1.13: Labour force participation rates by sex and age

	1996	1997	1998	1999	2000	2001
All	48.5	50.9	50.7	50.0	48.6	49.2
55 – 59	42.9	48.3	50.4	47.7	48.9	50.5
60 – 64	21.0	24.6	25.9	22.9	23.4	25.0
Male	56.3	58.3	58.7	57.9	55.2	55.3
55 – 59	59.5	63.5	64.2	64.5	62.7	61.8
60 – 64	30.0	31.4	35.1	32.0	33.5	31.2
Female	42.1	44.7	44.1	43.5	43.1	44.3
55- 59	29.8	36.4	39.7	34.7	38.3	41.7
60 – 64	14.6	19.8	19.4	16.5	16.2	20.5

Source: data of Central Statistical Bureau of Latvia

Table 1.14: Labour force structure (%)

	1996	1997	1998	1999	2000	2001
Employees	85.5	80.7	82.9	83.9	85.3	85.0
Self-employed	7.0	9.7	8.5	7.2	6.6	6.1
Civil servants	no data	0.9	0.8	0.8	0.6	2.8

Table 1.15: Divorce rate

	1996	1997	1998	1999	2000	2001
Divorce rate (per 1000 inhabitants)	3.1	2.5	2.5	2.9	2.6	

Source: data of Central Statistical Bureau of Latvia

Table 1.16: Age of mother (the average annual number of births per 1.000 women at specified ages)

	1996	1997	1998	1999	2000	2001
Women at the age of 15-49 *	32.5	31.0	30.4	32.0	34.2	
Of which:						
< 20	25.5	21.2	18.7	18.7	18.2	
20 – 24	89.4	83.1	79.1	79.2	78.7	
25 – 29	66.4	64.6	65.9	73.2	79.8	
30 – 34	32.5	33.9	35.9	39.2	46.3	
35 –39	14.4	14.8	14.6	16.4	19.4	
40 – 44	3.3	4.2	4.0	4.0	4.8	
45 – 49	0.2	0.2	0.3	0.2	0.3	

* Including births to women under 15 and at the age of 50 and over

Source: data of Central Statistical Bureau of Latvia

2. OVERVIEW OF THE SOCIAL PROTECTION SYSTEM

2.1 Organisational structure

2.1.1 Overview of the system

Latvian legislation does not provide an explicit definition of the term „social security“. Instead, both the Constitution (*Satversme*) and the framework law „On Social Security“ (*Par sociālo drošību*) refer to a series of social rights, granted to all residents of the Republic of Latvia.

The Constitution states: „Everyone has the right to social security in case of old age, incapacity for work, unemployment and in other cases as provided by law. The State shall protect and support marriage, family, rights of parents and rights of a child. The State shall provide special support to disabled children, children left without parental care or who have suffered from violence. The State shall protect human health and guarantee a basic level of medical assistance for everyone. Everyone has the right to education.“

The law „On Social Security“, which defines the basic principles of the social security system, differentiates between several categories of social rights:

- rights related to education and employment;
- right to social insurance;
- right to health-care;
- right to reimbursement of family expenses;
- right to social assistance;
- other social rights, such as integration of disabled persons etc.

The substance of social security arrangements is regulated by laws and Government legislation.

Latvian social security system consists of the following components:

1. Social insurance (*sociālā apdrošināšana*).
2. Health-care (*veselības aprūpe*).
3. State social benefits (*valsts sociālie pabalsti*).
4. Social assistance (*sociālā palīdzība*).

State social insurance is organised as a single work-based, contribution-financed system, mandatory for all employees and self-employed persons as well as assimilated categories of individuals, and open to residents who fall

outside this scope. It covers the risks of old-age, death, incapacity for work, maternity, labour accidents and professional diseases and unemployment. The personal scope of application, financing and organisation of social insurance is determined by the law „On State Social Insurance“, while several other laws deal with the specific schemes.

The Latvian health-care system is tax-financed with patients' co-payments. It grants all residents access to a defined minimum range of health-care services. At the moment, various aspects of health-care are regulated by a series of laws and regulations of the Cabinet of Ministers.

Basic principles of state social benefits and social assistance are regulated by the law „On Social Assistance“. State social benefits include family benefits and some other demogrants. They are tax-financed and available to all residents who meet the specified criteria. Social assistance includes means-tested benefits in cash and in kind, provided by municipalities and state to persons who cannot support themselves and lack sufficient support from other individuals.

The social protection system in Latvia is supervised by the Ministry of Welfare. The ministry is headed by the minister, who is politically responsible. The administrative work of the ministry is supervised by a state secretary who is a civil servant. The ministry consists of the following departments: the Department of Social Insurance, Social Assistance, Labour, Health, Environmental Health, Pharmacy, Social Policy Development, European and Legal Issues, Financing and Budget Department and the Administrative Department.

The Department of Social Insurance is responsible for the elaboration of social insurance legislation, social insurance policy development and the co-ordination of international relations and agreements related to social insurance.

The basic task of the Social Assistance Department is the formulation of the social assistance policy and monitoring of its implementation.

The Labour Department elaborates the governmental policy in the field of employment and work protection.

The executive of the Social Insurance Funds is the State Non-Profit Joint Stock Company State Social Insurance Agency. The control over the Agency's operations is conducted by a Council. The Chairman of the Council is the Minister of Welfare. The agency is responsible for the organisation of the statutory insurance and for payment of pensions and other benefits. The Agency operates through 33 local offices. They are responsible for collecting applications, all necessary documents, the calculation of benefits and payment of all kinds of social insurance benefits and state social security benefits. The information is passed on to the IT

Centre of the Social Insurance Agency in Riga where the calculations are reviewed and computerised.

The State Revenue Service is responsible for the social insurance contribution collection.

The Social Assistance Fund is performing the administrative and financial management functions of providers of state-run social assistance services. Another area of the activities of the Social Assistance Fund is to accumulate information about social services provided, in order to monitor and improve the system.

The main social assistance functions are performed by municipalities.

The formulation and implementation of employment policy is the responsibility of the non-profit public joint stock company State Employment Service, subordinated to the Ministry of Welfare. This organisation has local offices, which registers unemployed persons, but the emphasis is laid on active employment measures (vocational consulting, vocational training and retraining for the unemployed, paid temporary public jobs, job-seekers' clubs and other activities).

The main task of State Labour Inspectorate (SLI) is to monitor and control compliance with labour protection requirements, performing regular inspections of equipment used at work places. SLI is also entitled to control technical documentation and labelling.

The whole amount of resources allocated to health care are channelled to the State Compulsory Health Insurance Agency (SCHIA), which distributes it among territorial sickness funds. Some of the territorial sickness funds legally are branches of the SCHIA, while others are legal persons subordinated to the local municipalities.

The State Pharmaceutical Inspectorate exercises direct supervision and control over the market of medicinal products, provides control over manufacturing and distribution of high-quality, safe and effective medicinal products.

The main tasks of the State Agency of Pharmaceuticals are issuing market authorisations, supervision, control and regulation of the distribution of medicinal products.

2.1.2 Centralisation / De-centralisation of the system

Administration of compulsory state social insurance is highly centralised. The State Social Insurance Agency is acting through its branch offices.

In contrary, social assistance administration is de-centralised. The Law „On Local Governments“ becoming effective as of 1 January 1995, increased the autonomy of municipalities rapidly, coinciding in time with the decentralisation of the organisation of social assistance services started in 1994. Municipalities were entrusted with the task of providing social assistance services prescribed by law and given complete autonomy in planning and expanding financial resources projected for social assistance, as well as in organising social assistance services.

Development of a social dialogue requires the existence and involvement of trade unions and employers' associations. The experience of Latvia differs from the experience of other Central and East European countries where several diverse trade unions' and employers' organisations do exist. **The Free Trade Union Association of Latvia (FTUAL)** is the only trade union organisation comprising 27 sectoral trade unions. Its key principles are the equality of member organisations, solidarity, implementation of common interests and democratic representation at the institutions of the FTUAL, collegiate management, transparency, co-operation with non-governmental organisations and movements in Latvia and abroad whose aims and activities have an impact on the implementation of the interests of trade unions.

The main organisation of employers is the **Employers' Confederation of Latvia (ECL)**, which is a free and independent non-governmental organisation uniting employers and associations of employers registered in the Republic of Latvia and co-ordinating relations with employers in negotiations with institutions of public administration and trade unions on public and socio - economic issues.

The FTUAL and ECL have bilateral consultations consolidated by the General Agreement on Principles of Social Partnership of 22 July 1996 prescribing the procedure for concluding collective agreements and related dispute resolution at all levels - the enterprise, industry or national level.

In 2001, collective agreements covered 211 887 employees.

The national institution of tripartite social dialogue is the **National Tripartite Cooperation Council (NTCC)**. Three sub-councils operate within the institutional system of the NTCC:

1. Social Insurance Council;
2. Tripartite Co-operation Sub-council on Vocational Education and Employment;
3. Tripartite Co-operation Sub-council on Labour Affairs.

Councils are active in co-ordinating decisions on wages, benefits and other matters. The decisions of councils are only recommendations to Government.

In recent years, the number of *non-governmental organisations (NGOs)* has increased in Latvia and they also became more important in the political sphere. About 6000 NGOs are registered in Latvia. 870 of them have founded the *NGO Centre* whose tasks include support and consultation services for NGOs.

Even if the role of NGOs in Latvia has been considered as 'unrelevant' in the Human Development Report 2001, there are a number of indications for their increasing importance.

In the social field, Pensioners' Federation and the organisations of disabled and handicapped persons are active. The NGO Centre in the framework of project „Stop The Dependency“ offers assistance for preparation of projects for elderly NGO activists.

In August 1997 saw the organisation of a wide - ranging event in Valmiera „Women and Men in Dialogue“ that put gender equality issues on the public agenda and mobilised both state institutions and NGOs.

In 2001 the NGO for openness and transparency in governmental policy „Delna“ achieved a real victory - invitation to observe and participate in a confidential governmental tender procedure, the results of which were of great importance to the economic development of Latvia.

2.1.3 Supervision

The social protection system is supervised by the Ministry of Welfare.

The employment policy in Latvia is co-ordinated by the Ministry of Economy in formulating the annual National Employment Plan (NEP). In 2001, the NEP was developed on the basis of employment guidelines approved by the Council of EU for 2000.

The financial activities of social protection institutions are supervised by the Ministry of Finance and the State Control Committee.

Activities of all State Non-Profit Joint Stock Companies belonging to social protection system are audited yearly by independent auditors' companies.

2.2 Financing of social protection

2.2.1 Financing sources

State budgetary system consists of:

General Government Consolidated Budget, which includes:

1. Basic State Budget, out of which defence, public order and safety and education, some social benefits and institutions are financed.
2. State Social Insurance Budget (in status of special budget).
3. State Health Insurance Budget (in status of special budget).
4. Local Government Budgets (i.e. budgets of municipalities).

Social insurance schemes basically are financed by employers' and employees' contributions. For some periods, contributions are paid by Basic State Budget and social insurance funds.

State social security benefits (demogrant scheme) are financed by the Basic State Budget.

Health care services are financed partly by the state (from Basic State Budget) and partly by the patients.

Social assistance is basically financed from budgets of municipalities. Some social care institutions are financed by state (from Basic State Budget).

The minimum level of health care services is financed by the state. For staying in a health care institution patients pay a fee that does not exceed 15% of the costs of the medical services provided. In case a patient wants a separate room with comfort, the amount of payment for services is determined higher.

The actual situation of financing of each branch of social protection will be described in the corresponding chapters.

2.2.2 Financing principles

The state social insurance system in Latvia was created according to the redistribution principle (pay-as-you-go) with the objective to provide maximum compliance of the social security benefits with the paid social insurance contributions. There are no non-contributory redistributive elements in the social insurance system.

All rights in the social security field are highly individualised. There are only „direct rights“. Only in pension sector one can find some elements of

derived rights: survivors' pensions for dependent children, since unlike adults they have no possibility of establishing their economic and social independence.

The legal base of the system is the law „On State Social Insurance“, adopted on October 21 1997.

From July 1, 2001 the state funded pension scheme is operating in Latvia according to the accumulation and investment principle of the individual social insurance contributions. The law „On State Funded Pensions“ was adopted in the Parliament on February 17, 2000.

According to the official opinion, there exist a compulsory health *insurance* , organised by state. Health care services are financed partly by the state and partly by the patients. State resources for financing health care are earmarked: 28.4% of personal income tax revenues are allocated for financing health care and distributed according to the number of members of the respective sickness fund. The totality of payments made by a patient in one year is limited to a maximum of 80 LVL.

In the author's point of view, only one indication of the present scheme is characteristic for an insurance : earmarked revenues. At best, one can speak about „insurance approach“ as did Prof. D.Pieters (*see D.Pieters, Introduction into the basic Principles of Social Security, Kulwert Law and Taxation Publishers, 1993*).

Municipal social assistance benefits in cash and in kind as well as municipal care institutions are financed by budgets of local governments.

Some social care institutions are financed by the Basic State Budget.

2.2.3 Financial administration

Social insurance schemes are basically financed by employers' and employees' contributions. For certain periods, contributions are paid from state and social insurance budget. The contributions from the state budget are made in favour of the soldiers of the active army, persons taking care of children up to the age of 1.5 years and persons whose spouses are on diplomatic or consular duty abroad.

All employees and self-employed persons who have reached the age of 15 years, as well as unemployed persons, non-working disabled persons and the persons who receive maternity or sickness benefits are socially insured persons. The respective social insurance budget makes contributions for these categories.

The law anticipates the possibility to join the pension, maternity and sickness insurance voluntarily, if the person is not subject to compulsory social insurance.

According to the law „On State Social Insurance“, the total rate of compulsory contributions in case the employee shall be insured for all types of insurance is 33 percent of the contributions base. Compulsory contributions shall be made in equal parts by the employer and the employee. This rate does not include the rate of compulsory contributions for the work injury insurance. This rate and the distribution of it shall become effective by January 1, 2003. As described above, the next reduction is prescribed by law, but social partners have not reached an agreement yet.

From January 1, 2001 the total rate of compulsory contributions in general case is 35.09 percent, from which 26.09 percent are paid by the employer and 9 percent by the employee.

The rate of compulsory insurance contributions is distributed by types of the social insurance. For this year (2002) the distribution by types is defined by the Cabinet of Ministers as follows:

- pension insurance	27.10 %
- unemployment insurance	1.90 %
- work injury insurance	0.09 %
- disability insurance	3.76 %
- maternity, sickness	2.24 %

The law has taken in account that not each person has to be insured against all risks.

Self-employed persons are insured in pension insurance (27.10%), disability insurance (3.76%) and maternity and sickness insurance (1.41%). Thus the total contributions rate for self-employed persons is 32.27%.

Employees who have reached the age that allows them to receive an old-age pension, as well as disabled of groups 1 and 2 are insured in pension insurance, maternity and sickness insurance as well as in work injury insurance. The total contribution rate for those categories is 28.56%.

Compulsory social insurance contributions according to the respective contribution rate are paid into

1. State Pension Fund;
2. Employment Fund;
3. Work Injury Fund;
4. Disability, Maternity and Sickness Fund.

Each of the funds may have a reserve fund, where the surplus of the collected compulsory social insurance payments over the costs of social insurance services shall be transferred.

For persons who have joined (mandatory or voluntarily) the State Funded Pension Scheme, contribution amounting to 2% of the contribution base is channelled to this scheme. This share is scheduled to rise by 2% every year from 2007, until reaching 10% in year 2010.

Since 1998, compulsory contributions have been administered by the State Revenue Service, while the State Social Insurance Agency administers the social insurance budgets and benefits payable from the budgets.

The administration of compulsory contributions revealed following positive aspects:

- tax payers dealt with all tax-related issues (registration, payment, submission of forms) at one institution;
- tax audits were comprehensive i.e. concerned all taxes.

Contribution base and tax base

Social insurance contribution base (object) is any cash payment and material values given to a paid employee to satisfy personal, family or household needs. Minimum and maximum amounts of contributions base are determined by the Cabinet of Ministers.

The base of compulsory contributions is harmonised with the personal income tax base, i.e. all payments by the employer and other forms of remuneration.

Non-taxable income (not subject to personal income tax) includes state pensions (up to 100 LVL), grants and allowances, sickness and maternity benefits, payments to guardians, compensation for health-care expenses exceeding maximum amount determined by the Saeima or Government, dismissal allowances, compensation for damage to health resulting in loss of ability to work, grants to students, aid in case of natural disasters, remuneration to blood donors and funeral benefit paid by employer up to 150 LVL.

Generally the part of earnings up to 21 LVL is not subject to personal income tax, but the social insurance contributions are deducted from all earnings. For some categories (insured persons with dependants, disabled of categories I and II, politically persecuted persons), the non-taxable part of earnings is higher.

Up to year 1996, individual contributions were not registered. In 1997, the pensions were calculated in accordance with individual's contributions in

1996 registered on personal accounts. The outcome was shocking for the society. Variance between the lowest and highest pension was enormous.

Thus the decision was taken to introduce a limit of the annual income that the social insurance contribution shall be based on. The Pension law was amended, and now the Cabinet of Ministers each year determines the ceiling (for some categories - minimum too) of earnings, from which the contributions shall be deducted.

Table 2.1: The minimum and maximum of contributions base (object).

Status	Year	Minimum	Maximum
Employees and employees over retirement age and /or disabled of category I and II	1997	-	12000 LVL
	1998	-	12000 LVL
	1999	-	14000 LVL
	2000	-	15000 LVL
	2001	-	16000 LVL
	2002	-	17300 LVL
Self-employed and self-employed over retirement age and / or disabled of category I and II	1997	-	12000 LVL
	1998	504 LVL	12000 LVL
	1999	540 LVL	14000 LVL
	2000	540 LVL	15000 LVL
	2001	480 LVL	16000 LVL
	2002	480 LVL	17300 LVL
Foreigners, employed by a foreign tax payer	1998	-	12000 LVL
	1999	-	14000 LVL
	2000	-	15000 LVL
	2001	-	16000 LVL
	2002	-	17300 LVL
Permanent residents of Latvia employed in Latvia by a foreign tax payer	2000	-	15000 LVL
	2001	-	16000 LVL
	2002	-	17300 LVL
Voluntarily insured persons	1998	1428 LVL	12000 LVL
	1999	1080 LVL	14000 LVL
	2000	1080 LVL	15000 LVL
	2001	960 LVL	16000 LVL
	2002		17300 LVL

2.3 Overview of Allowances

2.3.1 Health care

Health care benefits (in kind) included in the minimum health care services may be received by citizens of the Republic of Latvia and non - citizens, as well as foreign nationals and stateless persons who have been granted a permanent residence permit for the Republic of Latvia.

National health - care system provides access to a specified minimum range of the health care services, which are tax - financed with patients co-payments.

2.3.2 Sickness (cash benefits)

Sickness insurance covers all employees and self-employed persons. Agricultural workers (self-employed persons) who have reached the retirement age or are disabled persons of category I or II, are not covered by the scheme.

There is no qualifying period required, only the incapacity for work has to be certified by a doctor. After one day's waiting period the claimant is entitled to sick pay paid by employer. The amount of sick pay has to be no less than 75% of average earnings for the 2nd and 3rd day of incapacity and no less than 80% of the average earnings from the 4th day. The social insurance sickness benefit is payable from the 15th day of incapacity for work until recovery or up to 52 weeks from day of incapacity for work, or 78 weeks within a 3 year period if the incapacity for work repeats. The benefit is payable from the 1st day if a person is caring for a child younger than 14 years.

The social insurance benefit is paid out in the amount of 80% of average insurance contributions wage¹.

2.3.3 Maternity

For benefits in kind, there are no qualifying conditions, only the incapacity to work has to be certified by doctor. The amount of maternity benefit is 100% average insurance contributions wage. Payable for 112 calendar days: 56 before and 56 after confinement. Payable for 14 additional calendar days in case of complications during pregnancy, delivery or post-delivery period, as well as in cases when 2 or more children are born and in cases when medical care associated with pregnancy at a medical institution has been started and continued before the 12th week of pregnancy.

Paternity benefit are also granted: 80% of the average insurance contributions wage for the period of duty leave (maximum 10 days) related to the birth of child.

¹ The average insurance contributions wage is the average individual earnings over a given period of time from which social insurance contributions are paid.

2.3.4 Disability (Invalidity), long-term care.

Social protection against the risk of disability includes:

- disability insurance providing an disability pension linked to contributions and period of insurance;
- state social benefits;
- social assistance benefits in cash and kind.

Disability pension is granted according to three categories of disability.

Category I: 0.45 times average contributions wage in 3 consecutive out of last 5 years, plus average contributions wage multiplied by ratio of years actually contributed to the total possible number of years between age 15 and general retirement age.

Minimum: 1.6 times the State social security benefit.

Category II: 0.4 times average wage in 3 consecutive of last 5 years, plus average wage multiplied by ratio of years actually contributed to the total possible number of years between age 15 and retirement age.

Minimum: 1.4 times the State social security benefit.

Category III: equal to the State social security benefit (30 LVL).

Pensions granted before 01.01.1996 are not subject to taxation.

The annual tax exemption limits: Categories I and II :1500 Ls; category III:1440 Ls.

Social assistance includes institutional social care services too. For example, nursing homes (centres) for the elderly, nursing homes (centres) for the mentally retarded, orphanages and some other care institutions. Those forms of social protection provide long-term care. Municipalities can provide care as a part of social assistance services. In Latvia, there is no special scheme for long-term care as in some European countries.

2.3.5 Old -age

Social protection in old -age includes:

- state social insurance providing an old - age pension;
- state social security benefits;
- social assistance benefits in cash and kind.

- Statutory social pension insurance system consists of tier I and II of the pension system.

1-st tier pension scheme is designed as an earnings related, defined contributions pension scheme which is financed on a pay-as-you-go basis, but is similar with respect to construction to a funded pension insurance scheme.

Pensions granted before 01.01.1996 are not subject to taxation.

Pensions granted or recalculated after 01.01.1996 are subject to taxation. The annual tax exemption limit is 12 000 LVL.

2-nd tier pension scheme - funded, benefits linked to the amount of accrued (real) pension capital. (*For more information see chapter 3 „Pensions“*).

The state social security benefit is universal and granted without means - test to persons at least 5 years older than the statutory retirement age.

2.3.6 Survivors

Survivors of deceased insured person or pensioner are entitled to survivors pension.

The amount of pension: 50% of (potential) old-age pension of insured deceased for one survivor; 75% for 2 survivors; 90% for 3 and more. Payable to children, dependent brothers, sisters and grandchildren under the age of 18 (24 for full- time students at secondary or higher education institution).

Full orphan's pension amount is based on the (potential) old-age pensions of both parents. There is no pension for a surviving spouse.

Minimum survivors pension is equal to State social security benefit.

If the survivor's pension is not granted because of an insufficient qualifying period of deceased, the State Social Security Benefit shall be granted.

2.3.7 Employment injuries and occupational diseases

This kind of social insurance was renewed only in 1997 (first law: 1927). Work injuries insurance covers wage and salary earners. No minimum qualifying period is required. The amount of temporary disability benefit is the same as for ordinary sickness periods.

The amount of permanent disability benefit is a percentage of insured person's average monthly contributions earnings depending on degree of disability : 80% for 100% loss of earning capacity, up to 75% if loss is 90 - 99 %; up to 70% if loss is 80- 89%, up to 65% if loss is 70- 79%, up to 60% if loss is 60 - 69%, up to 55% if loss is 50 -59%, up to 50% if loss is 40 - 49%, up to 45% if loss is 30 - 39%, up to 35% if loss is 25-29%, up to 30% if loss is 15 - 24%, up to 25% if loss is 10 - 14%.

Medical benefits: same as for ordinary illness plus reimbursement of additional expenses for medical treatment, nursing care, prosthesis, escort, travel expenses, occupational and social rehabilitation. Preventive measures are included in this type of insurance as well.

The amount of survivor's benefit: 25% of the average monthly earnings the deceased for one survivor, up to 35% for 2 survivors, up to 45% for 3 , up to 55% for 4 or more. Payable to children, dependent brothers, sisters, grandchildren, surviving spouse, parents and grandparents. Higher percentage for orphans.

2.3.8 Family benefits

All permanent residents with a child under 15 years of age (20 if at secondary school) are entitled to family benefits. Thus the coverage is universal. The amount of state family allowance equals 20% of the state social security benefit monthly for the first child, 1.2 times the amount for the first child for the second, - 1.6 times for the third, 1.8 times for the fourth and subsequent children. A supplement (35 LVL per month) is granted for a disabled child under age 16.

For support of families raising children, the legislation envisages some other allowances:

1. Childbirth allowance granted to:

- one of the parents;
- a person who has adopted or assumed guardianship of a child under the age of one year.

Lump sum of 98 LVL, which is doubled (196 LVL) for mothers who have undergone continuous medical examinations commencing before the 12th week of pregnancy.

2. Child-care allowance to non -working or partly employed parent, caring for a child under age three. The amount of allowance for a child under 18 months is 30 LVL, for a child from 18 months to 3 years - 7.50 LVL.

3. Compensation to a guardian for taking care of a child (i.e. to compensate the additional expenses for child-raising to some extent) - 22 LVL per month.

4. Allowance for the execution of the guardians duties - 38 LVL per month.

5. Compensation to foster family. The amount of allowance is set by municipality, but no less than 27 LVL per child.

6. Foster Family's Allowance - 38 LVL per month (does not depend upon the number of accepted foster children).

2.3.9 Unemployment

Qualifying conditions for entitlement to social insurance unemployment benefit are the registration at State Employment Service, a total insurance record not less than 1 year and 9 months insurance record in the 12 months before registering as unemployed.

The amount of unemployment benefit is determined by the length of the insurance record and the length of unemployment. For a 1 - 9 years insurance period, 50% of average contributions wage is granted; for 10 - 19 years, 55%; 20-29 years it is 60%; for a record over 30 years 65%. The full amount paid for the first 3 months, 75% for 4-6 and 50% for 7-9 months.

When the payment of unemployment benefit is suspended, the unemployed can rely only upon social assistance municipal allowances. Some experts estimate the principal municipal allowance - Social Assistance Allowance for Poor Families - as mainly acting as a form of extended unemployment benefit for low - income families with children, because the usual behavioural conditions attached to unemployment benefits are also attached to this allowance: for example, the allowance can be withheld if the applicant refuses suitable employment, including public works, or training or rehabilitation (see Handbook and Dictionary on Social Protection for Latvia, EC PHARE CONSENSUS PROGRAMME, ZZ -9505 -01 -10, PLS Consult,1998).

2.3.10 Minimum resources/ social assistance

Article 3 of the law „On Social Assistance“ defines the right to social assistance for person „who is not capable of taking care of himself/ herself or overcoming special hardships of life and who does not receive sufficient assistance from anybody else shall have the right to a personal and material aid which corresponds to the needs of the respective person, provides possibilities of self-assistance and facilitates his/ her integration into society.“

Although the State Social Benefits are included by the law in social assistance programme, in the author's point of view this type of benefits does not correspond to the definition of social assistance, since they are demogrant, i.e. tax financed benefits which are granted to all persons who belong to a certain category. Thus in this sub-chapter only those social assistance benefits and measures will be described, which do correspond to the definition of social assistance.

Municipal social benefits are a classical social assistance system. All of them are means - tested.

Purposes and aims of these allowances are expressed by their titles:

1. Poor family social assistance allowance.
2. Apartment allowances (mostly for the rent and utilities payment).
3. Allowance for care.
4. Allowance for food (mostly free meals at schools and kindergartens).
5. Reimbursement of expenditures of medical services.
6. Allowances related to the upbringing and education of children.
7. Allowances for single pensioners.

The data related to minimum resources was given in Chapter I (1.1.3.)

2.4 Summary: main principles and mechanisms of the social protection system

In terms of welfare regimes, Latvian social protection system has turned towards the conservative model (according to G. Esping-Andersen), meaning that the system is employment - centred. Most social risks are compensated through the social insurance system, taking into account insurance records and earnings.

The inhabitants-centred approach is realised to a much lesser extent (universal family benefits, means-tested social assistance benefits).

There are some signs witnessing that neo-liberal ideas are gaining weight. It will become obvious when analysing the implementation of pension reform.

Only limited attempts are made to use welfare to mitigate social inequalities.

The purpose of reforming the social protection system is to establish a democratic, stable and financially sustainable system which would allow to protect the socio-economic interests and health of each individual in the future. On the other hand, emphasis is set on each individual's responsibility for creation of his /her social security rights. When implementing the funded pension scheme, individuals will to a large extent take over the financial risks inherent to this system.

The 1st tier pension scheme was introduced with the goal to create a modest, cost- saving system. The scheme is not fair to pensioners, who retired before the new law became effective, because the previously acquired rights are not protected. In the Pension Reform Concept the transitory tier (4th tier) was foreseen to provide additional income for those who would retire before the new law takes effect, however this idea was not realised.

The fully-funded component in the pension system was introduced with the goal to encourage savings and promote the economic development. Some social security experts evaluate this approach as disregarding the social concerns. „Hence, the reform concept was strongly biased towards macroeconomic goals, while social concerns were only of secondary importance.“ (see Katharina Mueller“ *Old-age security in the Baltics: legacy, early reforms and recent trends*“, Frankfurt Institute for Transformation studies, nr. 7/01, 2001).

3. PENSIONS

3.1 Evaluation of current structures

3.1.1 Public - private mix

The Parliament approved the Pension Reform Concept in 1995. By implementation of the reform a pension system different from the classical continental pension insurance schemes of Europe, is being gradually introduced in Latvia.

In accordance with the concept the pension system will be designed in three tiers:

- The first – the state compulsory social insurance scheme operating according to the distribution (PAYG) principle.
- The second – the state compulsory funded pension scheme.
- The third – the private voluntary pension funds.

Although the first tier is a generation solidarity scheme, it also has its own different features. It is a scheme of defined contributions - so called Notional Defined Contribution (NDC) scheme: information about social insurance contribution payments is recorded on individual pension accounts building a 'notional capital'. However, money is not accumulated but is paid out to the current pensioners. The pension formula contains a component which depends on the demographic situation in the country: the forecasted life expectancy as of the moment of retirement. The notional pension capital, which is created as the sum of the contributions paid during the life time, is protected against loss of the actual value through indexation. Valorisation of pensions is anticipated as well.

The second pension tier will operate according to the accumulation and investment principle of the individual social insurance contributions. The law „On State Funded Pensions“ was adopted in the Parliament on 17 February 2000 and came into force on 1 July 2001.

In contrast to the first tier where notional capital is accumulated, actual capital will be accumulated in the second tier.

Third tier provides the possibility to make private savings in the pension funds. The law „On Private Pension Funds“ came into force on 1 July 1998. At the time being, there are four licensed private pension funds operating in Latvia.

The goal of the three-level pension system is the following:

- the 1st tier state mandatory unfunded pension scheme shall provide a stable, medium-low income replacement after retirement;
- the 2nd tier state mandatory/voluntary funded pension scheme shall provide a stable supplement to the income replacement, without increase of contributions to the old age pensions. Simultaneously, the scheme of the 1st tier is relieved and the development of the financial market is facilitated;
- the 3rd tier private funded pension scheme shall provide additional pension, financed by additional contributions.

Sticking to the PAYG system, this system would be able to finance sufficient pension payments to the existing pensioners, however, due to the increase in the demographic load, in the future the sustainability of the state social insurance system would be subject to risk.

In turn, the 2nd and 3rd tiers are subject to financial risks: passive financial markets, low profit margins, fluctuations of interest rates and prices of securities etc.

The new three-level pension system relieves the state liability on the residents old age insurance, makes the 1st tier scheme more resistant against different unfavourable factors, facilitates personal accumulations, and is designed to enhance the economic development.

If the supposed goals of the reform are achieved, Latvia should obtain a pension system protected against the two main risks inherent to each tier. The first tier PAYG benefits are subject to labour market risks while the second tier pensions are subject to capital market risks. Because capital and labour market risks tend to be unrelated, retirement income - subject to both risks - receives better protection from a diversified system than from a system protecting only against one risk.

The three tier pension system combines the principle of generation solidarity and personal responsibility for one's income in old age.

1st tier pensions provide a replacement rate of 40% - 50% of gross earnings. The projections are that the 1st tier and 2nd tier together will provide at least 70% replacement rate for persons who join the 2nd tier at the age of 20.

In the original Pension Reform Concept, a Transitory Tier (4th) was foreseen to provide additional income support for those retired before the new law takes effect, however this idea was not realised.

1st tier

The legal basis for the first tier is the law „On State Pensions“ (with Transitional Provisions), adopted on 2 November 1995, into force since 1 January 1996. Since then the law has been amended 9 times:

- 1) November 6, 1996, in force since December 10, 1996; minor amendments.
- 2) December 27, 1996, in force since January 7, 1997. The amendments introduced a new formula for the calculation of disability pensions. This formula was supposed to be an interim solution until a new concept of granting the disability status and solving the problems related thereto would be worked out and implemented.
- 3) May 22, 1997, in force since June 1, 1997 - amendments regarding minimum pension for early retired women and the maximum amount of pensions.

In the year 1996, since the individual earnings were not registered in the year 1995, for calculation of the amount of pension the national (not individual) average contributory wage in the year 1995 (85.00 LVL) was taken into account. Besides, in the year 1996 a supplement to newly granted pensions was provided. The amount of pension was calculated according to the new law. If this amount was lower than that calculated according to the previous legislation, a supplement was granted to cover the difference. Thus differences caused by the new law were not supposed to be perceptible.

From January 1997, pensions were calculated in accordance with the individual's earnings in 1996 registered on personal accounts. The outcome was shocking to the society. The variance between the lowest and highest pension amounts was enormous. Some of the lowest pensions amounted to 5 - 8 LVL, whereas the highest were over 1000 lats. The lowest pensions were allotted to women taking the early retirement option (at age 55). With respect to high pension levels, persons with high earnings, who claimed their pensions in 1996 became highly indignant (this indignation resulted in amendments made in 1998, described below). They were entitled to pensions which were calculated from the nationwide average earnings. Meanwhile people with the same career record and earnings who claimed their pensions in 1997 were granted pensions many times higher. In order to minimise the number of small pensions, the law was amended. Now the minimum pension for women taking early retirement was set at 80% of the state social security benefit (in 1998: 80% of 30 LVL = 24 LVL). The retirement conditions were improved for persons with at least 30 years work record in Latvia. If their contributions earnings in 1996/97 were less than the average contributions earnings of employed persons, the pension was to be calculated not from individual earnings, but from the average social insurance contributions earnings in 1996/97. The same applies to persons

which were registered as unemployed in 1996/97 and have at least 30 years work record in Latvia. A maximum amount of pensions was introduced as well (as a temporary provision until 31 December 1999). Some minor modifications were also made to the Transition Regulations of the law "On State Pensions".

4) November 20, 1997, in force since January 1, 1998. The amendments were introduced mainly in order to co-ordinate the law „On State Pensions“ with the provisions of the new law „On State Social Insurance“ (framework law for state social insurance) which came into force on January 1, 1998.

5) October 21, 1998, in force since January 1, 1999. Two weeks before the parliamentary elections to be held in October 1998 the law „On State Pensions“ was amended and some generous provisions came into force on January 1, 1999. The amendments provided:

- new regulations for re-granting of old age pensions, that is, persons who were granted old age pension before 1997 and who continued to work receiving high salaries were provided with the possibility to claim re-granting of the pension according to the Pension law of 1995.
- additional indexing rules for pensioners over the age of 80 which resulted in significant increase in pension amounts for this age group.

6) April 22, 1999, in force since May 1, 1999. Amendments regarding the indexing of pensions for persons older than 80 years, cancelling the amendments made on October 21, 1998. The previously planned formula for indexing pensions was replaced with a new instrument to increase the amount of pensions for the oldest group of pensioners in form of a supplement to the pension in the amount of 10% of the pension.

7) August 5, 1999, in force since 5 December 1999, and

8) November 4, 1999 in force since 6 December 1999.

As the financial situation of the social insurance budget worsened in 1999, the newly formed Government in July 1999 elaborated and submitted cost saving amendments to the law „On State Pensions“ to the Saeima (Parliament). I.e., it envisaged such measures as to abolish the amendments of the pre-election time described above and at the same time rapidly increase retirement age to 62 years for men and women, to abolish early retirement and suspend payment of pensions to employed pensioners.

The law was passed in Parliament on 5 August, however the left-wing opposition parties achieved a referendum on these amendments. While the referendum was in preparation, the Government elaborated new, „softened“ amendments to the law „On State Pensions“. The increase in retirement age was made more gradual: by 6 months each year until age 62 is reached.

Reduction in case of early retirement was to constitute 20% of the amount of pension.

The possibility of re-granting of pensions for persons who have been granted pensions before 1 January 1997 was excluded.

Supplements for persons older than 80 years were abolished.

Pension indexing was envisaged once a year (previously - twice), taking into account the consumer price index.

Working pensioners receive a partial pension –in the amount of 60 LVL.

The new amendments were passed in Parliament on 4 November 1999.

On 13 November 1999, the referendum took place but its results were not valid because the participation rate was not high enough. In point of fact, the people of Latvia not participating in the referendum thus had voted for the increase of retirement age and other cost saving provisions.

9) As the new elections approached, the law „On State Pensions“ was amended again on 20 December 2001.

The indexing rules were amended again. Not only the consumer price index, but also 50% of the insurance contributions earnings real growth index are to be taken into account. The logic behind this is that insurance contributions earnings are expected to grow faster than the consumer price index, so the new adjustment formula should benefit the pensioners. However, less generous transitional rules will apply until the end of 2005.

Working pensioners were now entitled to draw a pension not exceeding 3-times (instead of 2) the amount of state social security benefit. This ceiling was to be gradually raised over the next three years, and any restrictions would be cancelled by 2005. However, these provisions were later declared void by the Constitutional Court (see below).

For persons with at least 30 years insurance record, national average insurance contributions earnings during years 1996 - 1999 is considered as the minimum contribution basis. This provision applies to persons retiring in the years 2000 - 2009, and includes recalculation options for those who were granted a pension before the amendments came into force.

New minimum levels for old-age pensions were introduced (1.1 – 1.5 times the amount of state social security benefit, depending upon the duration of insurance record).

Pensions were made exportable.

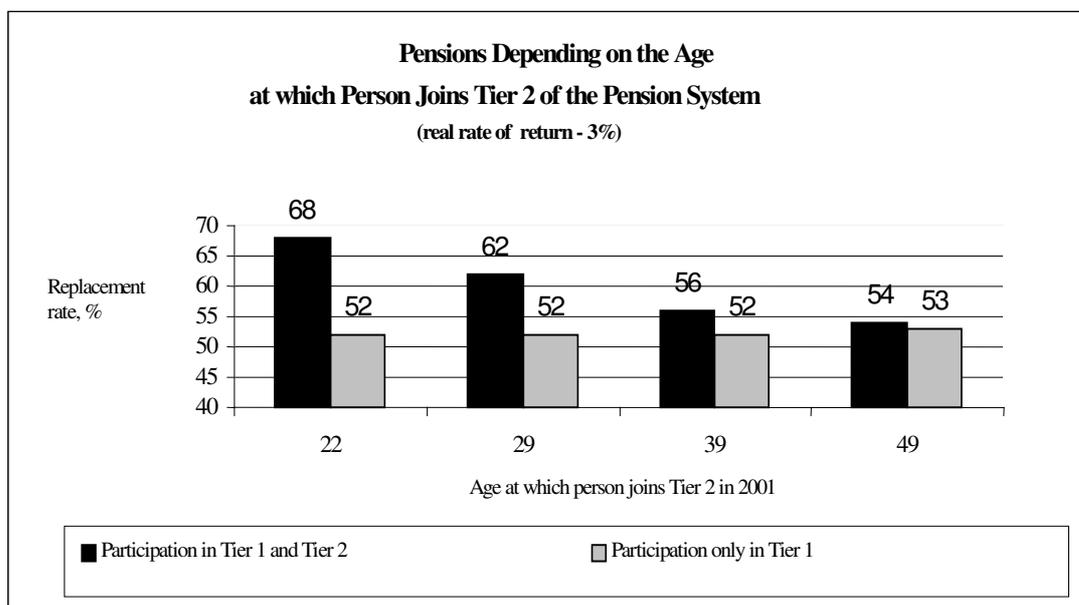
The legislative process has been further complicated by legal action in the Constitutional Court. During the past few years, the supreme judicial body of the Republic of Latvia has been several times involved in settling social protection matters. On 13 March 2001, the Constitutional Court ruled unlawful the link between entitlement to social insurance benefits and actual payment of the contributions. On 19 March 2002, the Court stated that the restrictions on pension amount for working pensioners infringed the constitutional right to social security in old age. As a result of the latter ruling, an increase in social insurance expenditure can be predicted, not at least because a significant number of working pensioners can now be expected to apply for a recalculation of their pension.

2nd tier

The law „On State Funded Pensions“ was adopted on 17 February 2000 and came into force on 1 July 2001. It was the final part of the legislative framework for the new Latvian pension system, developed under the guidance of the World Bank. It sets up the second tier pension, which operates according to the accumulation and investment principle of the individual social insurance contributions. In Latvia introduction of the second tier was purposefully delayed for 5 years (unlike Poland and Hungary where both tiers of the pension scheme were introduced simultaneously). In the meantime the first tier had matured, private pension funds had gained certain experience and the social administration – State Social Insurance Agency (SSIA) – had been prepared for the upcoming mission.

All socially insured persons aged under 30 on 1 July 2001 were obliged to join the second tier, while those aged 30-49 were free to do the same or, alternatively, to keep the whole of their contribution to the first tier pension scheme. People over 50 are required to remain in the first tier. However, despite some aggressive PR campaigning, only 5% of the potential voluntary participants had opted to join the 2nd tier by 1 October 2001. Majority of those who did were aged between 30 and 40.

The expected income replacement rate for persons joining the 2nd tier at different ages is demonstrated in the table below (calculations of the State Social Insurance Agency).



The 2nd tier of the Latvian pension system does not feature pension funds in the traditional sense. Administration remains a competency of the SSIA, which has contracted the Central Depositarium for the period of time 2003 – 2006 to administer the accounts of 2nd tier participants. Decisions concerning investment of assets are taken by the Asset Manager. For the first three years, functions of the Asset Manager will be performed solely by the State Treasury, after that each insured individual will be able to choose whether to switch to a private Asset Manager or to stick with the State Treasury. The actual capital will be kept in a Custodian Bank. Such a division of responsibilities was envisaged in order to ensure maximum safety of pension assets. Furthermore, the law prescribes that pension assets shall be kept apart from other assets both at Asset Managers and Custodian Banks. Activities of all institutions involved in the scheme are supervised by the Finance and Capital Market Commission. Strict investment rules were also developed to guarantee the safety of assets.

3rd tier

The extension of the 3rd tier depends on the development of the capital market and the banking sector. According to national accounts, the level of produced assets in Latvia at the beginning of 2000 equalled 164% of GDP (80% - fixed assets, 20% - inventories). Each year this level goes up, yet it is still low. In the first half of 2001 almost 14% of the aggregate demand consisted of expenditure of gross fixed capital formation that went up by 9.6% compared to the previous year. Investment by types of property between 1995 and 2000 testifies that rapid growth of investment was mainly ensured by investments in the private sector. Those went up in the average

by 49% per year exceeding investment in the public sector almost four times.

Relatively low level of investment in industry is mainly linked with low return on capital due to low profit. High costs of capital (high interest rates) are also mentioned by businesses as a hindrance for investment. Growth of investments is not supported either by the low capacity utilisation mainly caused by low domestic and external demand.

The Bank of Latvia (the central bank) implements the monetary policy of Latvia. The law „On the Bank of Latvia“ stipulates that the main goal of the monetary policy is to maintain price stability. The central bank is independent in its decision-making and is not subordinated to decisions or orders of the government. The Bank of Latvia is supervised by the Saeima (Parliament). The Bank of Latvia implements a conservative monetary policy supported by all the insofar governments.

Since 1994 the Bank of Latvia has unofficially pegged the exchange rate of LVL (lats) to SDR currency basket (1 SDR = 0.7997 LVL), thus *de facto* implementing the fixed national currency exchange rate policy. Central bank plans to preserve the current peg of the LVL to SRD until the time when Latvia accedes to the EU. The Bank of Latvia has managed to gain confidence, at the same time using a wide range of market-oriented monetary tools fully compatible with the monetary policy instruments at the disposal of the European Central Bank (ECB).

The main instrument of monetary policy is buying and selling foreign currency, including swap deals in LVL. This allows the Bank of Latvia to use its foreign currency reserves for regulation of the domestic money market without affecting the policy of interest rates. In the next 5 - 7 years it is planned to bring down the reserve requirement (5% from January 1, 2002) to the level of 2% recommended by ECB.

At the end of 2001 there were 22 banks in Latvia, 1 branch of a foreign bank (*Nordea Bank Finland Plc*, Latvian branch) and 1 representative office of a foreign bank (*Dresdner Bank AG*, Germany).

Assets of the five largest banks amount to 3/4 of total bank assets. Almost all banks are private. The share of the state in fixed assets of the banking sector is 3.7%. A more substantial share of state capital is found only in two banks - the *Mortgage and Land Bank of Latvia* - 100%, and *Latvijas Krājbanka (Savings Bank of Latvia)* - 32%. 2/3 of the paid fixed capital is non-resident investments. Main shareholders of Latvian banks are German, Swedish, Finnish, Estonian and Russian banks and several important international financial institutions (EBRD, Swedfund etc.).

The banking sector of Latvia is stable. Bank assets, deposits and extended loans are gradually increasing. Commercial banks work with profit. Further

increase of efficiency of the banking sector is closely linked with the development of the national economy, structural reforms and the development of capital and real estate market.

The banking supervision implemented in Latvia, in the opinion of many international experts, is one of the strictest among the countries of Central and Eastern Europe.

Nevertheless, the fact that over half of the deposits in the banking system consist of short-term foreign currency deposits held by non-residents - even in an off-shore banking arrangement - could complicate monetary management in the event of a sudden withdrawal of the funds. In addition, a portion of these deposits is now being re lent abroad. In general, because of Latvia's continued importance as a transit trade country for Russia, the relationship of Latvian banks to Russian companies remain strong. Going forth, however, the rapid expansion of credit, at an average of some 30% per year over the past two years, could pose a risk in the event of an economic slowdown (*Moody's Analysis - Latvia*).

If the Bank of Latvia has gained confidence of the population, it does not apply to commercial banks. Too much people had lost their savings during the banking crisis of 1995. The same applies to private pension funds. The idea to enable inhabitants to accrue private accumulation, guaranteeing additional income in old age, is so far put into practise by a small minority of the economically active population, however this number is growing. At the end of 2001, 17 359 people had invested money with the funds (a rise of 47% compared to the previous year), their total contributions amounting to 4.81 mln LVL (87% rise).

At the time being, there are four licensed private pension funds operating in Latvia. During the years 2001 and 2002 the number of participants in occupational plans has increased. *Pareksa atklātais pensiju fonds (Pareks Open Pension Fund)* is offering two pension plans: *Sociālais nodrošinājums (Social Ensuring)* for juridical persons and *Papildpensija (Supplementary Pension)* for physical persons. In the first plan, 41 agreements are registered. At the early stages such plans were more popular with undertakings based in Riga, but since then collective agreements have been concluded with undertakings representing all regions, as well as all sectors of industry and agriculture. The open pension fund *Baltikums* covers approximately 200 participants through occupational plans and 40 - through individual plans. Entrepreneurs engaged in occupational plans believe that employees are thus motivated to stick to their current employers.

Two more leading private banks – *Hansabanka* and *Rietumu banka* – are currently considering the possibility to set up pension funds.

As demonstrated by the above examples, private pension funds are both open and closed, participation is possible in individual as well as in

occupational plans. All plans are defined-contribution plans. The contributions (premiums) are exempt from income tax and social insurance contributions are not deducted from the premiums paid into the private pensions funds, provided those contributions (premiums) do not exceed 10% of gross salary.

As of 1 January 2002, receiving the accrued pension capital - the income gained from the investment of premiums - is exempt from income tax.

According to the data of Household Budget Survey by the Central Statistical Bureau, in 31.6% Latvian households pension is the main source of income (2000). The average disposable income of pensioners' households is 61.29 LVL per family member. In the overall income composition structure for all households, social transfers is the second most important source of income (28.1%), with pensions alone amounting to 23.6% in 2000. It has to be noted that the weight of social transfers in the population's income composition is gradually decreasing. In pensioners' households, social transfers in 2000 amounted to 83.0% of disposable income per household member, pensions alone making up 80.3%.

Table 3.1: Income composition of pensioners' households, % of disposable income per household member (2000)

Labour income	All social transfers (including pensions)	of which pensions	Net income from agricultural activities	Net income from entrepreneurs hip and craft	other income
6.6	83.0	80.3	2.6	0.2	7.6

Source: Household Budget Survey, CSB

To sum it up, the Latvian pension system departs from the traditional European divide between public, compulsory, PAYG schemes on the one hand and private, voluntary, funded schemes on the other. Under the influence of economic imperatives, historical legacy and international pressure, Latvia has developed a new design of the public/private mix. The main specificity is the compulsory state funded pension scheme (2nd tier), which plays an important part particularly in providing old-age security. Beside that, the Latvian system comprises a compulsory 1st tier PAYG scheme, characterised by a specific „insurance-oriented“ calculation mechanism, and a voluntary 3rd tier which features private funded pensions, including occupational provisions.

3.1.2 Benefits

The pensions amount is determined by the individual's lifetime earnings (or more precisely - by the lump sum of social insurance contributions paid in). On retirement the aggregate pension (the sum of the contributions paid in and the amounts this sum of pension credits has been increased by) is

divided by the so-called divider. This is primarily based on the average projected life expectancy at the time of retirement, providing for the annual pension amount in the reformed system.

The retirement pension shall be calculated according to the following formula:

$$P = K / G$$

P - annual pension

K - the pension capital of the insured person, composed of the amount of social insurance contributions registered on the personal account and the annual capital growth, which is dependant on the social insurance contributions earnings index determined by the Cabinet of Ministers.

G - the life expectancy after the pension allotment.

G is the time period (years) counted on basis of the life expectancy of the years of the allotment of the retirement pension; this period is determined by the Cabinet of Ministers following the data from the Central Bureau of Statistics and calculations made in the Ministry of Welfare. "G" depends on the age at which the individual wishes to retire and also on the life expectancy forecast in that period. Therefore it is possible that the "G" will be different from the life expectancy determined by the state statistics for the particular year. As the same life expectancy is used for men and women, there will be some re-distribution of resources within the system due to the differences in the average age of men and women.

Minimum pension is equal to the State social security benefit (30 LVL). If the insurance period is at least 20 years, minimum pension is increased by factor 1.1, with insurance period 20 - 30 years - by 1.3, more then 30 years - by 1.5.

Minimum early retirement pension is equal to 80% of the State social security benefit or 24 LVL.

Indexation

According to the pension law, the pensions are adjusted annually taking into consideration both inflation and the real growth of wages, using the so-called economic adjustment indexing. The economic adjustment indexing means that pensions will be linked to real growth of contribution wage sum.

Indexation does not apply to pensions exceeding the amount of state social security benefit (30 LVL per month) 5 times. As the inflation rate is low, the increase in pensions amount is insignificant. In year 2000 the pension amount was increased by an average of 0.18 LVL, in year 2001 - by

1.40 LVL. As of year 2002 pensions are indexed, taking into account the price increase as well as the increase in the average social insurance contributions wage. Indexation of this kind will compensate not only for the decline of the purchasing power due to inflation, but will also ensure a real increase in pensions amounts. In view of the budget deficit, pensions will be indexed only by 25% of the actual increase in the average insurance contributions wage and later - depending on the financial situation of the country.

Taxation

The part of pension exceeding 100 LVL is income-taxed (25%).

Transitional provisions

The law prescribes transitional provisions for persons retiring in the period of the first 10 years after the law comes into effect. For these persons, the insurance period until the year of 1995 (inclusive) shall be credited with an initial capital (K), which may be increased with further contributions. $K = V * A * 0.2$, where A is the insurance record until year 1995, V- the average social insurance contributions earnings, adjusted to the 1996 level of wages. In order to compensate for the special rights that were provided by the previous pension legislation, there is a quotient determined to the pensions of the insured persons, for whom the previous legislation provided better conditions concerning retirement age.

The amount of pension for those retiring at the statutory retirement age should not be smaller than the amount of the state social security benefit (30 LVL). Those who retired in 1996 received an additional payment, if the pension calculated in accordance with the new law was less than the pension calculated in accordance with previous law.

Recalculation of already allotted old-age pensions shall be done in connection with increase of the insurance record . In those cases the pensions are recalculated according to a formula specified in the transitional provisions of the law „On State Pensions“.

Retirement age

Introducing the pension law, the retirement age was supposed to be flexible: the pension calculation formula provides an incentive to postpone the retirement. Still, the practice of the first five years (1996 - 2001) of the reform has shown that the possibility to postpone the retirement is used rarely and does not effect the general retirement age.

The retirement age prescribed by law - 62 years - is much higher than the previous retirement age (until 1 January 1996 - 55 years for women, 60 for

men). The transition to the retirement age prescribed by law is gradual – in 1996 the retirement age for women was raised by one year, while each following year on 1 July it is raised by 6 months. The increase of the retirement age of men was started in 2000; it is raised gradually by six month on 1 January of each subsequent year. Men will reach the retirement age of 62 years on 1 January 2003, women - on 1 July 2008.

Until the year 2005, early retirement is also possible: for women it is two years before the retirement age prescribed by law, for men - starting with the age 60. Early retirement is only possible if the length of the insurance period is not less than 30 years.

The amount of early pension is 80% of the calculated pension until the time when the statutory retirement age is reached.

Table 3.2: Retirement age (effective and statutory)

	1995	2000	2001
Effective			
For men	59.35	60.29	60.56
For women	56.17	56.77	56.70
Legal			
For men	60	60.5	61
For women	55	58*	58.5**

* Until 30 June 57.5 years, as of first July - 58 years.

** Until 30 June 58 years, as of first July - 58.5 years.

Source: Data of Ministry of Welfare

Table 3.3: Replacement rate

	1995	1996	1997	1998	1999	2000	2001
from average gross wages	36.4%	38.8%	35.4%	38.7%	41.8%	40.0%	37.8%
from average contributions wage*	39.2%	41.4%	38.3%	42.1%	46.0%	43.7%	41.5%
from average net wages	44.4%	48.7%	48.2%	52.9%	57.4%	55.1%	52.4%

* Wage from which actual contributions have been paid

Source: Data of Ministry of Welfare

Disability pension

The new regulations on granting disability pensions came into force on 7 January 1997. These amendments to the law „On State Pensions“ introduced the minimum insurance period for eligibility to a disability pension – 3

years. The disability pension is granted and paid until the moment when the person is entitled to an old age pension.

An insured person is entitled to a disability pension provided 1) his/her insurance record is no less than three years; 2) disability has been established by the Health and Working Capacity Medical Expert Commission.

Disability pension is paid at three levels, for partial loss of earnings capacity (category III), total loss (category II) and total loss with need for care (category I). The level of benefit takes account of the length of social insurance record as well as the previous income.

Disability pension is granted according to the category of disability.

In case of disability of category I and category II the calculation shall be made according to the following formula:

Category I

$$P = 0.45 \times V_i + (A_{Si} / A_{Sie}) \times V_i \times 0.1$$

Category II

$$p = 0.4 \times V_i + (A_{Si} / A_{Sie}) \times V_i \times 0.1$$

P: pension amount;

- **V_i** - average contributions wage of the insured person for any consecutive 36 months (irrespective of the length of interruption of the employment) over the last five years prior to the granting of the disability pension but no more then the amount equal to five officially determined minimum wages;
- **A_{Si}** - individual insurance record of the insured person;
- **A_{Sie}** - maximum possible insurance record from the age 15 until retirement age.

For disabled persons of category III the benefit is fixed as the amount of the state social security benefit (30 LVL per month).

The amount of disability pension for categories I and II shall be no less than the amount of state social security benefit to which the following coefficient shall be applied:

- in case of disability of category I - 1.6;
- in case of disability of category II - 1.4.

Survivor's benefits for dependents

Survivor's pension **amount to 50%** of the (potential) old-age pension of insured deceased for one survivor; **75%** for 2 survivors; **90%** for 3 and more. They are payable to children, dependent brothers, sisters and grandchildren. The full orphans pension amount is based on (potential) old-age pensions of both parents.

The minimum survivor's pension is equal to the State social security benefit.

Table 3.4: Number of pension recipients and amount of pension benefits

	1995	1996	1997	1998	1999	2000	2001
Number of pension recipients (thous.)*	637.9	640.8	643.0	638.7	643.3	633.0	620.9
Old age pensions	497.0	504.0	511.2	512.5	521.0	513.8	504.8
Disability pensions	103.4	98.5	94.5	90.1	85.8	83.2	80.5
Survivor's pensions	29.9	30.2	28.9	28.5	28.5	28.2	27.9
Service pensions	6.1	6.1	6.3	5.2	5.2	5.2	5.1
Pensions under special regulations	1.5	2.0	2.3	2.4	2.8	2.7	2.5
Average amount of pension (LVL, per month) *	32.72	38.50	42.42	51.23	58.00	59.10	60.50
Old age pensions	32.60	38.30	42.55	51.57	58.92	60.28	61.83
Disability pensions	33.90	39.20	42.81	50.86	54.70	54.49	55.04
Survivor's pensions	28.20	32.20	35.94	42.17	46.82	46.86	47.59
Service pensions	31.80	37.40	45.70	61.18	70.64	71.12	72.41
Pensions under special regulations	64.40	64.00	69.50	77.72	81.70	82.55	85.27

* pensions of the Ministry of Interior not included. The average amount of pensions is given in real prices.

Source: data of State Social Insurance Agency.

As the table shows, the number of pension recipients is decreasing and the average amount of monthly pensions is increasing.

The number of old age pensions recipients has decreased in 2001 in comparison with 2000 by 1.74%, but the average amount of old age pensions has increased by 2.57%. At the same time one can observe a worrying trend - the amount of newly granted pensions is declining. In year 2001 the average amount of newly granted pensions has decreased by 4.48 LVL or by 8.1% in comparison with the year 2000.

The Central Statistical Bureau (CSB) has calculated the poverty head-count ratio and the poverty gap index, depending on the number of pensioners in the household.

Table 3.5: Poverty head-count ratio and the number of pensioners in the household

Year	1996	1997	1998	1999	2000
No pensioners in household	16.7	17.1	17.8	17.8	19.3
1 pensioner in household	16.0	17.2	20.3	21.0	23.4
2 pensioners in household	8.9	12.7	15.7	16.9	16.6

Source: CSB

Table 3.6: Poverty gap index and the number of pensioners in the household

Year	1996	1997	1998	1999	2000
No pensioners in household	0.05	0.05	0.05	0.06	0.06
1 pensioner in household	0.04	0.04	0.05	0.06	0.07
2 pensioners in household	0.02	0.03	0.04	0.04	0.04

Source: CSB

As it is obvious from the tables, households with one pensioner are characterised by the highest poverty risk. At the same time, households with two pensioners are even better off than households without pensioners. The latter observation stresses the point that Latvian pensions, although mostly below the statistical subsistence minimum, still provide a stable source of income and the poverty risk for pensioners is smaller than for other perceived „risk groups“. For more details regarding pensions and the issue of poverty, see 4.2.2.

3.1.3 Financing of the pension system

For the first time since 1995, the state social insurance budget closed the year 1999 with a fiscal deficit of LVL 57.6 mln. As a result, revenues were insufficient to ensure the payment of benefits, whereas the increase in expenditure was affected by generous amendments made to the law „On State Pensions“ two weeks before the parliamentary elections held in October 1998. Sources for financing the deficit were funds still at disposal at the beginning of the year (LVL 20.2 mln) and a loan from the basic state budget (LVL 37.3 mln).

As the state pensions special budget forms the main part of state social insurance budget (77.16% of total state social insurance budget), it was highly affected by the growing deficit.

Table 3.7: State pension insurance budget

	2001, mln. LVL			2002**, mln LVL		
	planned*	execution	execution as % of planned	planned for budget year	execution over 3 months	execution over 3 months as % of planned
Revenues	404.01	392.64	97.2%	417.59	101.63	24.3%
Expenditures	420.65	398.79	94.8%	431.15	103.43	24.0%
Financial balance	- 16.64	- 6.14		-13.56	-1.80	

* According to the Law on State Budget for year 2001.

** According to the Law on State Budget for year 2002.

The fiscal deficit in year 2001 amounted to 6.14 mln. LVL. In year 2002 the pensions insurance budget is planned with a fiscal deficit of 13.56 mln LVL. Results of the first three months show a positive trend - the deficit is growing slower than it was planned. The decrease of deficit was achieved thanks to the cost saving amendments made to the Pension law in late 1999.

With the aim to create better environment for business (especially for foreign investment), the social insurance contributions rate has been reduced gradually: starting with the rate 38% (37% -employer; 1% - employee) and ending with the rate 33.09% (17.09% - employer; 16.% - employee) in January 1, 2003. In years 2001 and 2002 the rate is divided between employer and employee: 26.09% and 9% of gross earnings correspondingly. On 27 December 2002 it was decided that for the year 2003 the total contributions rate will be 33.09%, where 24.09% are paid by the employer and 9% by the employee. The Ministry of Finance estimates that the reduction of the contribution rate by 2% will reduce the revenues of social insurance budget by 30 million LVL annually.

At the same time, for persons who have joined (mandatory or voluntarily) the State Funded Pension Scheme, contributions of 2% are channelled to this scheme. This proportion is scheduled to rise until reaching 10% in year 2010. Taking into account that the cohort subject to mandatory participation is growing each year, the revenues allocated to the first tier pension scheme will decrease considerably. The official prediction given in 1.2.1 anticipates that the deficit (with the accumulated negative reserve) will end by 2007 - 2010. In the author's opinion, this prediction is somewhat optimistic. With the debt to the State Basic Budget growing each year (according to data of State Social Insurance Agency, in 2002 it will constitute 20% of the whole social insurance budget), decreased contributions rate, 10% of contributions being channelled into 2nd tier pension scheme, it is hard to believe that the resources in the 1st tier pension scheme will be sufficient to guarantee the

average replacement rate (40% of lifetime gross earnings) calculated for this scheme. It gives rise to particular concern that there may be the return to the initial concept advocated by the World Bank: „Pillar 1 - the Public Pillar - very modest state insurance scheme, contribution financed, with the average replacement rate: initially 30 - 35 percent of average wage, falling to 20 percent over time as other pillars phase in.“

Originally, the legislation linked entitlement to social insurance benefits to the fact that contributions had actually been made. The scale of „grey“ extra-legal employment combined with the poor tax discipline in the Latvian business world left significant numbers of people unprotected. The ruling of the Constitutional Court of 13 March 2001 declared these provisions unlawful. Relevant amendments have been made to the laws „On State Social Insurance“ and „On State Pensions“.

One of the key ideas behind the Pension Reform Concept was the attempt to create a clear and direct link between the sum of social insurance contributions paid in and the amount of benefits granted in the insurance case. Among other aspirations, such an approach was supposed to strengthen incentives for individuals to make the due social insurance contributions. Especially in the new old-age pension formula, this idea was realised in a very straightforward way – by directly linking the pension amount to the pension capital accrued during the working life.

The early experiences of the new system lets us suggest that the main factor hindering the expected effect in the domain of incentives is the dented trust of the population in the social insurance system and the pension system in particular, caused by the frequent changes in legislation. Although the main principles of the reform have remained intact, various issues related to the transitional provisions have proved to be extremely sensitive, which has hardly helped to build popular trust in social guarantees provided by the state. It has to be added that in a situation of poor tax discipline and widespread „grey employment“ employees may risk their job if pressing for their remuneration to be legalised. Altogether, it is obvious that strengthening incentives is a major challenge – and a tough one as well – for Latvian policy makers and administrators.

3.1.4 Coverage of the system

Compulsorily insured persons are:

1. all individuals who have reached the age of 15 and who are employed by an employer - domestic taxpayer;
2. active military conscripts;
3. individuals nursing children, who have not reached the age of 1.5 years;
4. unemployed persons;

5. unemployed disabled persons;
6. individuals receiving maternity or sickness benefit;
7. individuals whose spouse is on diplomatic or consular duty abroad and who are residing in the relevant foreign country as a spouse of an individual performing diplomatic or consular services;
8. self - employed persons.

Pension insurance can be voluntarily joined by any individual who has reached the age of 15 and is not covered by compulsory insurance.

Beside the general pension insurance system, there are special pensions for some categories of people: 1) State President; 2) police; 3) State Prosecutors; 4) persons in active military service; 5) MPs who voted for independence in 1990; 6) children of people killed during the independence struggle of 1991. They are generally covered from state budget. Pensions of police, prosecutors and army are service pensions, granted upon completing a given service period. They are paid entirely from state budget until the person reaches legal retirement age. After that the social insurance budget pays the pension amount due from the performed contributions, while the rest of the pension is still paid from the state budget.

In 2001, the number of socially insured persons was 1 018 807 (including 909 655 employees and 12 815 self-employed) and it tends to grow; during the period since 1997 the number of insured persons has increased by 68 207. Thus 85.4 % of the economically active population is covered by social insurance.

It can be explained by the growing awareness among general public of the significance of social insurance contributions as well as the fact that the labour market is entered by young people, born at late 70s and the beginning of the 80s, when the birth rate was high.

Persons who are self-employed in the understanding of the law „On State Social Insurance“ are subject to compulsory social insurance, with the following exceptions:

- owners of a farmers' (fishermen's) farm not being in the employment legal relations with the management institution of the respective farmers' (fishermen's) farm and performing its management function, provided no manager (director) has been appointed (elected) under the law, who have reached retirement age or are disabled persons of category I or II (high degree of incapacity);
- individuals performing management of real estate or profiting from a personal farm or household and registered as tax-payers from economic activity, who have reached retirement age or are disabled persons of category I or II;

- individuals permanently residing in the Republic of Latvia and receiving the author's remuneration (except the inheritor of the author rights and other take-over of author rights), who have reached retirement age or are disabled persons of category I or II.

In contrast to wage earners, self-employed persons are considered socially insured only if contributions have actually been made. Self-employed persons who are subject to pension insurance are generally insured for the risks of old-age, death and disability, however self-employed persons who have reached retirement age and/or are disabled persons of category I or II are not insured for the risk of disability.

Individuals who are not subject to compulsory insurance, may join some kinds of pension insurance on a voluntary basis, provided they are residents of Latvia aged 15 and over and meet certain conditions:

- individuals who have not been granted an old-age pension may join insurance against the risks of old-age and death;
- spouses of self-employed persons who have not reached retirement age may join insurance against the risks of old-age, death and disability.

Persons who are both self-employed and wage earners are insured only for their activities as employees.

3.1.5 Public acceptance of the system

Public opinion polls are conducted on a regular basis by the Ministry of Welfare and State Social Insurance Agency in co-operation with the Baltic Social Sciences Institute. In the framework of the latest survey, conducted in the year 2000, the respondents were asked to evaluate the positive and negative aspects of the pension reform. Almost all respondents appreciate the basic principle of the pension reform - the link between benefits and contributions. However the respondents pointed out that they did not believe the system was actually working.

Retired respondents and respondents of pre-retirement age stressed the following negative aspects:

- frequent changes in the legislation has dented the trust in the in the pension system;
- retirement age is too high, especially for women, disregarding the poor state of health in the population and the average life expectancy;
- pension amount insufficient for meeting the minimum living standard.

Young people do not believe in the current social insurance system either. As a result, they find a situation where the employer does not make the social insurance contributions or makes them only from the minimum wage

acceptable. Respondents generally believe that both the employer and employee are to blame for this kind of situation, although some respondents hold the opinion that under the threat of firing the employee doesn't have much choice.

The State Social Insurance Agency (SSIA) was created as a „client-oriented administration“, thus public opinion polling is a part of the Agency's activities. In 2001 the Agency carried out a repeated customers satisfaction survey. The previous survey of similar kind had been carried out in 1998. In comparison to 1998, answers were less polarised; 'medium' assessment prevailed. 73% of customers reported general satisfaction with the Agency's activities. The survey also showed that people were less often forced to visit SSIA office repeatedly in order to be granted a benefit. The share of customers who had been granted the benefit at the first visit had increased from 68% in 1998 to 81% in 2001.

3.2 Evaluation of future challenges

3.2.1 Main challenges

The future effectiveness of the pension system will largely depend on the population's trust in the stability of the system. It goes without saying that the sustainability of any social insurance system heavily relies on trust. In case of Latvia, this trust has been severely dented by the frequent, inconsistent changes in legislation, while the belief in capitalised provisions has also been impaired by the banking crisis that Latvia has experienced in the past. The trust deficit is closely related to another challenge – the necessity to overcome the negative impact of shadow economy, tax evasion etc. Some positive changes in the existing situation can be expected along with the development, stabilisation and structural improvements of the free market mechanisms in Latvia, still significant efforts from the social policy side are also required in order to break the current deadlock.

In the author's point of view, it is undesirable that at this stage the pension reform was designed as the main contributor to the ongoing overall reform process, targeted only on economic goals while leaving social concerns disregarded. The justification for such approach was: when the economic goals are reached it will become possible to strengthen the social safety net and increase the benefits paid.

3.2.2 Financial sustainability

The pension reform was carried out taking into account the economic and demographic estimates as to possible long - term costs. Economic Analysis and Forecasts Division was established at the State Social Insurance Department of the Ministry of Welfare, where the all the possible scenarios are developed, taking into account the current situation and making forecasts

and projections until year 2050. Nevertheless, as described in 3.1.3, the author regards the predictions for solving the 1st tier financial problems as unduly optimistic.

However, the estimates of independent international experts do correspond to the forecasts of the Ministry of Welfare. „In the area of pension reform, Latvia has entered a new phase with the introduction on July 2001 of the second, fully funded pension pillar. This, together with the PAYG pension system and private pension funds, should provide a sufficient pension base, as well as bolster private savings. Second pension pillar, mandatory for those under the age of 30 and voluntary for those aged 30 to 49, will be financed by gradually increasing contributions so as not to undermine the financial stability of the first, PAYG, pillar. Additional measures to tighten the eligibility requirements for early retirement schemes and introduce measures to increase social contributions through higher labour participation are expected to reverse the slippage in pension fund finances and ensure financial stability of pension system funding. Moreover, the accumulation of reserves in the second tier pension fund is expected to reach between 20% and 40% of GDP by 2035.“ (*Moody's Analysis - Latvia*).

3.2.3 Pension policy and EU accession

In the year 2000, the legislative acts of Latvia were partially harmonised with the *acquis communautaire*. In several areas the legislation of Latvia already was in compliance with EU requirements, e.g. the legislation of Latvia prohibited any kind of discrimination.

Some requirements needed only amendments to the existing laws, e.g. in order to formally ensure equal treatment in the area of social security, minor amendments were made to the Law „On State Social Insurance“ and the Law „On State Pensions“.

At the end of 1999, the law „On State Social Insurance“ was amended to ensure compliance of legislative norms with the requirements of the *acquis*:

- the spouse of a self-employed person is given the opportunity to contribute, voluntarily, to maternity, sickness and disability insurance, as well as pension insurance;
- foreign employees working for an employer – a foreigner who has been sent to perform a specific assignment in Latvia for a period not in excess of 12 month are not subject to compulsory social insurance if compulsory contributions are made for them in their country of origin.

Both amendments became effective on 1 January 2001.

The Law „On State Pensions“ was amended in December 2001 and the export of pensions was renewed as of 1 January 2002. Another step in the

process of aligning the Latvian legislation with the *acquis* is the amendments (currently in the pipeline) to the law „On Private Pension Funds“, removing the provision prohibiting private pension funds to invest more than 15% of their accounts outside the country. Thus the law will be adapted to the free movement of capital.

The chapter „Social Policy and Employment“ in the negotiations with the EU member states is already provisionally closed - thus provisional agreement on the implementation of the requirements of the EU *Acquis Communautaire* has been reached.

Current Latvian administration is not sufficiently familiar with dealing with international claims and co-ordination techniques although some practical experience has been gained while implementing bilateral agreements – also with Member States. Special problems arise in co-ordination of 1-st tier pension scheme which is not always easy to co-ordinate with traditional European social insurance schemes.

A more fundamental problem could be raised by the calculation of second tier pensions for the purposes of co-ordination. The pro rata principle has so far proved considerably useful to the case of co-ordination, but it was not designed for funded benefits. Is the current calculation mechanism adaptable to capitalisation schemes, considering that such variables as capital accumulation and pension fund's performance come into play? At this moment, Latvia is prepared to take the simplest route and award pensioners, who have completed insurance records under various national systems, with a pension according to the capital that has been accumulated in Latvia. However, this solution may be challenged under the current EC law as inconsistent with the principles of co-ordination.

For the year 2003, it is foreseen to start an extensive PHARE project aiming to define the existing problems and find their solutions. The training of the staff involved is also included in the project.

3.3 Evaluation of recent and planned reforms

3.3.1 Recent reforms and their objectives

In 1996 Latvia transformed the state pension scheme (1st tier) .The reform of the 1st tier had the following purposes:

- to ensure the sustainability of the state pension system based on the principles of the solidarity of generations in the conditions of the demographic ageing of the population;
- to provide a replacement of income in the case of old age, disability and survivorship;
- to improve the transparency of the system;

- to create incentives for participation and accurate declaration of social insurance contribution payments.

The new pension scheme costs less than the previous system. As the amount of the first tier scheme is fully dependent on social contribution payments and the retirement age, such scheme is supposed to be self-financing and stable in the long term.

The winners of the 1st tier pension scheme are those with a long insurance record and large income from which social insurance contributions are (honestly) made. Losers are those, who had retired before the new law was enacted and people who have had low income or were unemployed in the time period from 1996 to 1999 and later.

The second tier pension scheme has the objective to acquire pension capital and thus an increase in pensions by investing the contribution payments in the financial market. As subordinate objectives Ministry of Welfare (see *Social Report 2001*) names:

- to promote the development of investment, stimulating the economic development of the country as a guarantee for developed social security system in Latvia;
- to promote the development of the financial and capital markets.

While for the foreseeable future the main form of security in old age will remain the state social insurance pension, efforts should be focused on developing private pension funds.

On the whole, the reform of the pension system in the domain of legislation has been completed. However the process of aligning legal norms related to the 1st tier pension scheme continues, as it is necessary to strengthen the transparency, fairness and benefit adequacy of the scheme.

The end result of the reform - the termination of early retirement and essential increase in the retirement age – has been delayed due to the high unemployment rate in many rural districts of Latvia, in particular in the age group of the pre-retirement age.

3.3.2 Political directions of future reforms

The Latvian pension reform has reached the stage where the legislative basis of the new system has been put into place, and the main tasks for the years to come lie in the field of implementation and management. At the moment it seems unlikely that the basic principles will be altered in foreseeable future. The reform has already outlasted 6 governments, although it has to be mentioned that all of them have been right-of-centre. At the same time, the elaborate transitional provisions are experiencing regular amendments,

as political parties try to impress voters in the pre-election period and rush back to cost-saving measures in the meantime.

As a rule, the opposition parties once in a while present some plans to reform the pension system, but, as a rule, they are restricted to general statements, involving repeated use of words „fair“, „efficient“ etc., with little indication how that might be achieved. Indeed, evolution of Latvian pension policy has so far been characterised by lack of profound, argued social policy debate.

One crucial variable of the Latvian social insurance system, the future shape of which is still unclear, is the contribution rate. The original reform plan envisaged to reduce it to 33% and split equally between the employee and employer, but this scenario looks ever less likely as the time passes by. At the moment, the ruling coalition appears to prefer a rate of 33%, where the employer would pay 24% and the employee – 9%, however it still has to be approved.

3.3.3 Conclusions

The pension system in Latvia has changed dramatically and its role as a distributor and equaliser is diminishing. It has been cited as an example for other Central and Eastern European countries to follow. According to the Ministry of Welfare and the World Bank, Latvia was the first country in this region to begin radically reforming a pension reform inherited from the Soviet regime. However, Poland and Hungary have now overtaken Latvia in reforming their pension systems.

Pension reform has succeeded in ensuring a sustainable pension system in Latvia, to a certain extent differentiated according to the amount of social insurance contributions paid by the individual, and in line with the available financial resources. The reform of the pension system has been more rapid than the improvement in the situation in pension recipients, partly because reforming such a system requires much less financial resources than improving the general welfare of such large group of the population.

The authors of Latvia Human Development Report 2000/2001 point out: „The average Latvian pension still remains considerably below the value of the minimum goods and services basket, although the difference between these two indicators is steadily diminishing. The gradually diminishing difference between the amount of the average pension and the minimum consumption basket shows that the present pension system has the potential to significantly improve the welfare of a large part of the population, and thus promote human development as a whole.“

It is true that the average amount of pensions is gradually growing, but on the other hand, after the cost-saving amendments to the law „On State Pensions“ in 1999, the amount of newly granted pensions in years 2000 and

2001 has decreased. More than half of newly granted pensions (in year 2000 - 60%, in 2001 - 52%) were minimum pensions. The average amount of newly granted pension in year 2001 has decreased by 10.6% in comparison with the average amount of newly granted pension in year 1999. This trend contributes to increased inequalities in income distribution among the population.

An important step towards solving the problem has been the reinstatement of the provision that the initial capital for a person with a long insurance period (not less than 30 years) is to be calculated on the basis of the national average social insurance contributions wage, thus contributing to the adequacy and fairness of pension benefits.

4. POVERTY AND SOCIAL EXCLUSION

4.1 Evaluation of current profiles of poverty and social exclusion

4.1.1 Social exclusion and poverty within the overall social protection system

For a long time, social exclusion and poverty *per se* was not recognised as a major problem in Latvia. The attitude prevailing in political circles was that Latvia should not bother about poverty, but about raising the general welfare level, i.e. when the overall economic situation improves, poverty will disappear automatically. This attitude hindered development of poverty reduction policy, and it was not until 1998 when Latvia showed serious commitment in combating poverty and social exclusion. The initiative was spurred to life by international social policy actors. In February 1998, the Ministry of Welfare and United Nations Development Programme (UNDP) in co-operation with the World Bank and the International Labour Organisation (ILO) launched a project in support of development of a National Poverty Reduction Strategy, which was aimed „to promote sustainable human development through poverty reduction efforts“. In the framework of this project, a series of valuable poverty research papers were published, which are also referred to in this report. In recent years, accession negotiations with the European Union (EU) have also played an important part in highlighting social exclusion problems in Latvia and triggering social policy measures aimed to address these problems.

In the author's point of view, the reserved attitude prevailing in Latvia towards social inclusion, stems from the economic, political and, last but not least, cultural background of Latvian social policy. Policy makers' and public opinion on social policy, social exclusion and poverty has been strongly influenced by pre-determined patterns of attitudes, beliefs and criteria of deservingness. As a rule, people who have suffered from a high degree of social exclusion are regarded by public opinion in a less favourable way than other risk groups. In case of Latvia, the latter attitude is further strengthened by the heritage of the Soviet era, when poverty was officially non-existent and only heavily morally degraded persons, e.g. alcohol addicts, were believed to suffer from such 'exceptional' hardships.

General economic decline that Latvia experienced in the first half of the 90ies and the lasting hardships of a transition economy, which triggered rise in poverty, also led to a decline in all fields of social protection. As a result, such groups as pensioners, families with children etc. faced substantially reduced levels of social guarantees – often to such a level that endangered their social status. Still, the problem was viewed mainly in the context of the economic situation by policy-makers or, as the critics of the state social policy stressed, in the shortcomings of the social security system. Social

exclusion and poverty were not recognised as a field deserving special attention.

Throughout the 90ies, these issues, especially problems related to old-age pensions, occupied the limelight of social policy debate. The well-being of pensioners, particularly in comparison to the solid social guarantees of the Soviet period, was generally regarded as the most important social problem. This attitude was stressed by the public belief that old-age pensioners had „earned“ their pension, i.e., they were seen as a highly deserving group. Only towards the end of the 90ies, data of the Household Budget Survey proved that other groups of population, such as families with children and, most of all, single mothers, actually experienced greater hardships. In general terms, these risk groups are also recognised as deserving, which is reflected by the implementation of municipal social assistance.

Table 4.1: Poverty head-count ratio for various household types (poverty threshold = 50% equivalent expenditure)

Year	1996	1997	1998	1999	2000
All households	15.1	16.4	18.2	18.6	20.3
Households with no pensioners	16.7	17.1	17.8	17.8	19.3
Households with 2 pensioners	8.9	12.7	15.7	16.9	16.6
Households with no children	12.1	13.3	15.8	15.6	18.7
Households with 2 children	17.5	18.2	21.4	19.1	23.0
Households with 1 adult and 1 child	19.1	21.9	18.5	18.1	25.7
Households with 1 unemployed	27.7	30.4	30.4	28.5	30.3
Households with 2 unemployed	43.9	52.2	60.0	44.4	44.2

Source: Household Budget Survey by Central Statistical Board (CSB)

Table 4.2: Poverty gap index for various household types (poverty threshold = 50% expenditure per equivalent consumer)

Year	1996	1997	1998	1999	2000
All households	0.04	0.04	0.05	0.05	0.06
Households with no pensioners	0.05	0.05	0.05	0.06	0.06
Households with 2 pensioners	0.02	0.03	0.04	0.04	0.04
Households with no children	0.03	0.03	0.04	0.04	0.05
Households with 2 children	0.05	0.04	0.06	0.05	0.07
Households with 1 adult and 1 child	0.06	0.06	0.05	0.06	0.10
Households with 1 unemployed	0.08	0.09	0.10	0.08	0.08
Households with 2 unemployed	0.15	0.19	0.20	0.16	0.18

Source: Household Budget Survey by Central Statistical Board (CSB)

Earlier in this report, design of the Latvian social protection system was described. By definition, the last social protection stronghold in the battle against poverty and social exclusion is the social assistance system (see 2.3.10). The current reform process, launched in 1996, is aimed to „establish a social assistance system which guarantees effective integration of individuals into the social and economic life“ (SR). In principle, social assistance should provide a safety net where other social guarantees have failed. In practise, however, the implementation of social assistance provisions, particularly municipal social benefits, provides a good example of the attitudes and beliefs prevailing in the Latvian social protection system.

As the income situation of a large part of the population is lagging behind the price development and this persisted for several years, the range of social problems encountered by residents is expanding with every passing year. The system of municipal social benefits reacts to these problems by trying to use benefits for purposes not listed in the law to give an opportunity to inhabitants to receive health care, educational services and to provide support in the upbringing and education of children. Benefits are given to a wide group of poor to maintain access to services and living standards, rather than targeted at the poorest. Annual statistical reports of municipal social assistance services show that the poor population constitutes the smallest percentage among recipients of municipal benefits (Social Report 2001). Thus, one can conclude that the current social assistance system focuses on supporting the living standard of those social groups which are seen as potentially at risk from social exclusion, and somewhat neglects those persons who have already suffered from a higher degree of exclusion. An effective social safety net is missing. The Social Report by the Ministry of Welfare admits: „It points to the necessity of altering the system of municipal benefits to stimulate the stabilisation of income of a person up to a certain level without restricting the choice of purposes for the use of benefits.“ (Social Report 2001, MoW)

The concept of „social exclusion“ is itself new to the Latvian social policy arena. So far it has made its way into the vocabulary of civil servants, administrators and experts, but is seldom if ever used by policy makers. The traditional concept of „poverty“ is used more willingly.

An important step in the development of Latvia's social inclusion policy was taken in February 2000, when the Cabinet of Ministers approved the Concept Paper of Provision of Guaranteed Minimum Income Level to Needy Persons, developed in cooperation with the World Bank. The concept set out the main points of a thorough reform of the social assistance system, focused on establishing strict nation-wide criteria in providing social assistance to needy persons. The notion of Guaranteed Minimum Income (GMI) – certain minimum level of income provided by state to all residents (conditional upon cooperation) – is at the centre of the concept. The aim of

this provision is to ensure that the neediest persons receive the assistance first or, in other words, to set up a social safety net for the least protected members of the society. There will be only one means-tested municipal social assistance benefit, initially set at the level of allowance paid to low-income families. After providing the given benefit to all residents eligible to receive it, local governments will have a right to pay benefits for various purposes in line with their budgetary capabilities, as has been done until now. Supervision of the provision of social services will be entrusted to the Social Assistance Fund (public agency subordinated to the Ministry of Welfare).

On the basis of the GMI concept, legislative initiative has followed. Amendments to the law „On Social Assistance“, bringing the concept to life, are to come into force on 1 January 2003. It can be seen as an important breakthrough in favour of the neediest part of population.

In August 2000, Cabinet of Ministers approved the Poverty Reduction Strategy. The strategy sets the task to improve quality of life of poor people and people with low income and till 2015 to bring the share of poor people down to 10% of the total population (see 4.1.2 for the relevant poverty criteria). The basic benchmarks for poverty reduction were adopted. Action Plan for Poverty Reduction was developed on the basis of the Strategy. First draft of the document was turned down by the Cabinet, and the plan is currently being redrafted by the Ministry of Welfare.

At the moment, one can find around 20 conceptual and other Government documents dealing with poverty.

National definitions of poverty and social exclusion

Poverty Reduction Strategy defines poverty in the following way:

„Situation where an individual or a certain part of the population find themselves when, because of insufficient material and social resources, they have limited opportunities to obtain the essentials (food, shelter, clothing and in some cases also care) and participate in society to the extent considered acceptable in that society.“

The notion of „social exclusion“ is hardly ever included in domestic social policy documents, although the above-mentioned definition of poverty also refers to the social aspect of poverty.

There is no uniform poverty line in Latvia. Regulations of the Cabinet of Ministers of 26 March 1996 „**On Poor Families**’ Social Assistance Benefit and Assessment of the Material Situation in Poor Families“ refers to 75% of the „crisis subsistence minimum“ as calculated for year 1994 (38.23 LVL per month), as there is no capacity to enforce a higher standard. According to these Regulations, a family is recognised to be poor if:

1. its income per family member during the last three months does not exceed 75% of the crisis subsistence minimum established by the Cabinet of Ministers (75% of 38.23 LVL = 28.67 LVL);
2. it has no money savings exceeding 200 LVL;
3. it does not own property with the value over 3000 LVL;
4. it has no providers (basically relatives) who can provide food;
5. it has not concluded an agreement on food (work for food).

The crisis subsistence minimum is calculated regularly by the Central Statistical Bureau (CSB) of Latvia. However, this calculated minimum does not have any impact on the status of needy persons. The average crisis subsistence minimum in 2001, according to calculations of CSB, was 86.93 LVL.

The **Poverty Reduction Strategy** differentiates between „poor“ and „low income“ persons, depending on the level of household income. Persons whose income does not exceed 28.67 LVL are deemed to be „poor“. Persons whose average monthly income during the previous year has been less than 50% of the average disposable income per household member (calculated according to the results of CSB Household Survey) are considered as „low income“. (That is, if we choose believe the Latvian original of the concept. The English translation of the strategy gives the two definitions vice versa...)

For statistical purposes, the Central Statistical Bureau has chosen 3 conditional minimal poverty thresholds based on **consumption expenditure**:

1. The lowest minimal consumption threshold: 50% of average consumption expenditure per an equivalent consumer;
2. The next minimal consumption threshold: 60% of average consumption expenditure per an equivalent consumer;
3. The highest minimal consumption threshold: 70% of average consumption expenditure per an equivalent consumer.

Approval of the GMI concept in fact means that the state has set an **actual subsistence minimum**, i.e. a minimum that it undertakes to ensure. In February 2000, when the Government approved the concept, the guaranteed minimum income was set at the level of benefits currently paid to low-income families – 21 LVL.

Vulnerable Groups

Several most vulnerable groups can be identified in Latvia, however obtained in the household budget survey testify that that **families with children** and **households with unemployed persons** are experiencing the

greatest difficulties of all risk groups, much greater than, for instance, **pensioners' households**. The situation of various household types vis-à-vis the risk of poverty and social exclusion will be more closely dealt with in respective chapters.

When calculating poverty risk for different socio-demographic groups, conclusion has been made that poverty in Latvia has a considerable gender dimension. With an increasing number of children or other family members, poverty rates for women are higher. **Women with children** are poorer than women without children. That lets us conclude that women taking care of family and children have restricted economic possibilities.

For women, poverty is a real threat during the whole lifetime. The average wage of women is substantially lower than that of men, they have more erratic employment records and correspondingly, the average pension is lower. As long as the statutory retirement age for women is lower, it reflects in the amount of pension, as well because the divider in the pension formula is the undifferentiated average life expectancy at retirement. The situation is worsened by the fact that a major part of elderly women are single (divorced, widows). The absence of survivor's pension for widows strengthens the difference in old age security between men and women.

Table 4.3: Poverty by gender of household head (aged 65 and over) (%; poverty line = 38 LVL)

	Head-count ratio	Poverty gap index
Male head	32.77	6.86
Female head	39.75	10.58

Source: Who and Where are Poor in Latvia, Franziska Gassmann, 2000 (based on CSB data for 1996)

4.1.2 18 EU Indicators of Social Exclusion

Data matching the 18 EU indicators of social exclusion are only partially available for Latvia. This is due to differences in methods, which on some occasions are based on objective reasons. For instance, as regards indicators 1, 3, 4 (residents whose income is below 60% of national average, with numerous specifications), one has to keep in mind the perpetual discussion among statisticians and researchers, whether the best way to measure poverty is income- or expenditure-based. In case of Latvia, the expenditure approach appears to have a strong case. Reliable data on residents' income are hard to collect and do not always provide an objective picture of the household's true financial situation. Therefore the Central Statistical Board prefers to use conditional minimal poverty thresholds based on consumption expenditure rather than income, for purposes of measuring poverty, although

income-related data are also collected. However, just like in most other fields, the Latvian statistical system is undergoing profound reform, and harmonised EU statistical standards are introduced one by one. Latvia has undertaken to achieve full compliance with EU standards by 1 January 2003.

Table 4.4: The 18 EU indicators of social exclusion

Indicator	1996	1997	1998	1999	2000	2001
1. Low income rate after transfers with low-income threshold set at 60% of median income	15.8	15.5	16.6	15.6	16.2	
2. Distribution of income (income quintile ratio)	5.0	4.8	5.4	5.1	5.5	
3. Persistence of low income						
4. Median low income gap						
5. Regional cohesion						
6. Long term unemployment rate: total	11.6	8.9	7.7	7.6	8.4	7.4
Males:	11.9	9.0	8.0	7.8	9.1	8.4
Females:	11.2	8.8	7.4	7.5	7.7	6.4
7. People living in jobless households						
8. Early school leavers not in further education or training						
9. Life expectancy at birth						
MALES	63.9	64.2	64.1	64.9	64.9	65.2
Females	75.6	75.9	75.5	76.2	76.0	76.6
10. Self perceived health status						
11. Dispersion around the 60% median low income threshold						
12. Low income rate anchored at a point in time						

13. Low income rate before transfers	21.9	22.0	22.3	22.4	22.2													
14. Distribution of income (Gini coefficient)	0.30	0.31	0.32	0.33	0.34	0.34												
15. Persistence of low income (based on 50% of median income)																		
16. Long term unemployment share: total	56.7	57.8	53.8	52.9	57.6	55.5												
Males	57.0	58.1	54.7	51.2	58.1	56.8												
Females	56.3	57.5	52.8	54.9	57.0	53.8												
17. Very long term unemployment rate: total	7.6	5.8	5.3	5.3	5.6	4.8												
Males	7.8	5.8	5.5	5.3	5.9	5.4												
Females	7.3	5.7	5.0	5.3	5.2	4.1												
18. Persons with low educational attainment:																		
	1996			1997			1998			1999			2000			2001		
	Total	M	F															
25 – 34	7.0	8.2	5.7	7.7	11.2	4.3	8.0	10.9	5.1	8.8	10.7	6.8	11.3	13.2	9.4	18.0	22.0	14.1
35 – 44	9.1	11.2	7.1	8.4	9.9	7.1	6.8	9.2	4.6	8.2	10.7	5.9	8.0	9.8	6.4	9.3	11.7	6.9
45 – 54	21.4	25.0	18.4	21.1	22.8	19.6	18.8	21.4	16.5	15.9	18.7	13.5	16.5	20.0	13.5	20.6	25.9	16.0
55 – 64	42.8	41.7	43.6	40.4	39.1	41.3	38.1	40.0	36.7	35.1	37.0	33.7	33.8	36.0	32.1	36.7	38.8	35.1

M = male; F = Female

Source: information provided by CSB

The introduction of uniform European indicators would be an important step towards a clearly structured national policy stand on poverty and social exclusion. At the moment, national poverty policy is only starting to develop and there is no single official poverty line. Apart from statistical hardships, this is a matter of political relevance, since the absence of strict criteria hinders policy development and strategic planning and opens way to biased and politically motivated interpretations of the existing situation. In addition, viable cross-national comparisons are only possible, if strict uniform criteria are observed.

The appropriateness of EU indicators for Latvia is a topic for a separate discussion. One dimension of the problem is the already mentioned

unreliability of income data in Latvia. It applies both to official data and survey results, as people are reluctant to report their true income. Hopefully, the situation will improve along with tax collecting and legal control of the labour market.

4.2 Evaluation of Policy Challenges and Policy Responses

4.2.1 Inclusive Labour Markets

Unemployment is one of the primary causes that may lead to poverty and social exclusion (see table on page 2). Unemployment has a negative effect on living standards and antipoverty policies will have to focus, among other target groups, on the unemployed. Data of the Household Budget Survey show a clear and persisting link between employment and expenditure level of a household. Therefore it is of interest here to take a closer look at the characteristics of the unemployed, try to identify the factors behind the facts and take a look at the policy measures aimed at improving the situation. The same of course applies to poor quality employment.

It has to be noted that the gap between the estimated number of non-working job seekers and the number of unemployed persons officially registered at the State Employment Service (SES) remains high, resulting, inter alia, in low social protection coverage (see 4.2.2). Major part of all job seekers are not registered and follow job ads, question their relatives and acquaintances and apply directly to employers in order to get a job. It has to be mentioned that unemployed persons over retirement age are not registered as unemployed by SES, although they may be looking for a job in practise.

Data obtained by means of Labour Force Survey, which covers all job seekers (according to ILO methodology) including those who try to find a job without official registration at the SES, are therefore important to get an idea of the real picture. However, one has to be very careful when considering the relevance of different data sources. For instance, according to the data of Labour Force Survey by CSB, only 30.9% of male and 34.7% of female job seekers reported they had registered with the State Employment Service in November 2000. At the same, comparing the rate of unemployed job seekers to the official data of SES, we see a different picture:

Table 4.6: Unemployment rates, Latvia

Year	1996	1997	1998	1999	2000
Unemployed job seekers, % of economically active population	19.4	14.8	14.0	13.5	13.2
Registered unemployed, % of economically active population	7.2	7.0	9.2	9.1	7.8

Source: CSB

In order to understand the prevailing trends, attention should be paid to several key groups characterised by specific labour market risks – young persons, persons of pre-retirement age, women and, in particular, long-term unemployed. The unemployed persons belonging to these groups find it particularly difficult to enter (or re-enter) the labour market and thus are subject to a high risk of social exclusion.

Table 4.7: Basic unemployment indicators, % of the total number of unemployed at the end of the year

Year	1995	1996	1997	1998	1999	2000
Long-term unemployed	25.5	31.2	38.1	26.3	31.1	29.0
Unemployed women	52.3	54.7	59.4	58.5	57.4	57.6
Young unemployed (aged 15-24)	20.2	20.0	18.1	16.4	14.8	14.7
Unemployed of pre-retirement age	12.3	11.4	12.4	13.2	13.7	14.7

Source: Social Report 2001

Table 4.8: Jobseekers rate in various age groups, ILO definition (% of economically active population)

	1996	1997	1998	1999	2000
15+	20.6	15.1	14.1	14.3	14.4
15-24	32.0	24.9	25.8	24.4	22.5
25-34	19.9	14.2	12.5	13.8	13.8
35-44	17.1	13.6	12.6	13.1	14.3
45-54	16.8	15.0	13.9	14.0	14.0
55-64	21.8	11.5	10.2	8.5	9.7
65-74	29.2	6.3	7.3	8.8	5.5
75+	13.1	8.6	1.8	1.5	15.3
15-64	20.5	15.4	14.3	14.5	14.6
15-74	20.7	15.2	14.2	14.3	14.4

Source: CSB

Table 4.9: Jobseekers rate, males

	1996	1997	1998	1999	2000
15+	21.0	15.4	14.4	15.0	15.4
15-24	32.4	24.4	24.5	25.7	21.5
25-34	18.6	12.6	11.4	13.3	14.1
35-44	18.1	12.9	12.7	14.5	15.2
45-54	18.5	16.6	15.4	15.1	17.1
55-64	20.3	14.1	12.9	8.1	10.7
65-74	21.8	10.7	6.9	9.3	3.1
75+	16.8	6.8	0.0	0.0	21.2
15-64	21.0	15.5	14.6	15.2	15.6
15-74	21.0	15.4	14.5	15.0	15.3

Source: CSB

Table 4.10: Jobseekers rate, females

	1996	1997	1998	1999	2000
15+	20.3	14.9	13.8	13.5	13.5
15-24	31.5	25.6	27.5	22.4	24.0
25-34	21.4	16.0	13.7	14.5	13.5
35-44	16.2	14.2	12.5	11.8	13.5
45-54	15.3	13.6	12.6	13.0	11.5
55-64	24.1	7.8	6.4	9.0	8.4
65-74	35.9	3.3	7.6	8.2	8.0
75+	9.8	9.4	2.7	2.1	13.2
15-64	20.0	15.3	14.0	13.7	13.6
15-74	20.4	14.9	13.9	13.6	13.5

Source: CSB

According to findings of LFS, the highest rate of non-working job seekers to the economically active population in the corresponding age group (ILO definition) is actually in the age group of 15-19 years. This is due to the fact that employers often prefer to hire people with work experience and that it is simply difficult to find a first job in a depressed labour market. It also suggests, however, that there may be problems with the adjustment of the educational system to the new knowledge and skill demands of the labour market. (Poverty and the Labour Market in Latvia, Marteen Keune, 2000) Since 1995 when the above-mentioned survey was launched, the rate of job seekers in this age group has been gradually decreasing – from 43.2% in 1995 to 35.2% in November 2000. At the same time, the number of persons who attended higher educational establishments has been on the increase. This process was promoted by the increasing demand on the labour market for high-quality labour force. (Trends and Indicators on Child and Family Well-being in Latvia, CSB, 2000). Gender gap in the age group 15-19 has decreased over the last years, however the rate of job seekers is still higher for women (36.6% in November 2000, compared to 34.4% for men). At the same time, the rate of registered unemployed show that persons aged 15-19 are not apt to register with SES

Gradual rise in the socio-economic situation of the state is having a positive effect on the employment situation. The number of unemployed job seekers continues to diminish. This is mainly explained by the fact that young people having reached working age do not start working immediately, but rather continue studies in different educational establishments.

Table 4.11: Educational enrolment

Year	1996	1997	1998	1999	2000
Enrolment in general secondary schools, thsd (at the beginning of school year)	48.9	52.7	57.9	62.4	63.2
Enrolment in vocational schools, thsd (at the beginning of school year)	43.1	45.7	46.2	47.7	48.6
New enrollees in higher educational institutions in full-time studies, thsd	11.0	11.7	16.8	18.5	21.0
Rate of economic activity in the age group 15-19 years, %	28.0	23.6	19.7	17.5	13.2

Source: CSB

This trend was not affected even by the Russian financial crisis of 1998, which triggered a short-term decline in Latvian economy in 1999, due to the close economic ties between the two countries. At the same time, the Russian crisis clearly influenced the number of unemployed persons who registered at the State Employment Service.

According to the data of Labour Force Survey, rate of job seekers in Latvia is the lowest in pre-retirement age. For November 2000, rate of job seekers in the age group 55-59 was 11.4% (13.3% for men and 9.0% for women), while in the age group 60-64 it was 7.4% (6.8% for men and 8.3% for women).

In general terms, the rate of job seekers in Latvia has a trend to stabilise. Men are generally more active in looking for employment. According to the data of 2000, the overall job seekers rate is higher for men – 15.6% of the economically active male contingent, compared to 13.5% for women. This is due to a higher job seekers rate for men in all age groups between 25 and 59 (except the age group 40-44).

No data regarding the unemployment rate among partially disabled individuals are available. Another group characterised by a very high risk of labour market exclusion is former convicts. Unfortunately, exact data are missing as well.

A worrying trend is the remaining dominance of women among unemployed persons, which is somewhat contrary to the situation in the job seekers contingent, as reported by respondents. The gender gap in the unemployment field has increased towards the end of the 90ies. Surveys

confirm that women with children are confronted with a certain degree of discrimination on the labour market.

The ratio of the unemployed in the age group over 55 increased by 14% in 2000. It is mostly related to the increase of unemployment among women caused by raising of the retirement age.

There are significant regional differences in the unemployment rate in the country. At the end of 2000, the lowest unemployment rate by a great margin was observed in the capital city Riga (3.7%). The unemployment rate in the Eastern region Latgale was considerably higher than the national average – more than 20% throughout the region, up to 25.6% in the Rēzekne district.

As regards long-term unemployment, LFS shows the following picture:

Table 4.12: Long-term jobseekers as % of economically active population

	1996	1997	1998	1999	2000
Total	11.6	8.9	7.7	7.6	8.4
Males	11.9	9.0	8.0	7.8	9.1
Females	11.2	8.8	7.4	7.5	7.7

The ratio of registered long-term unemployed decreased in 2000 – from 31.9% early in the year to 29.0% at the end of it. The problem of long-term unemployment also shows a clear regional dimension. The average ratio of the long-term unemployed in Latgale exceeds 50%. Latgale is also characterised by high ratio of other risk groups (unemployed women, young and elderly unemployed) in the total number of unemployed persons. The population group most affected by long-term unemployment are unemployed rural males.

Unemployment shows a clear relationship with the level of education.

Table 4.13: Unemployed persons by educational qualification (thsd, at the end of the year)

Year	1996	1997	1998	1999	2000
Total	90.8	84.9	111.4	109.5	93.3
With higher education	5.5	5.2	7.6	7.8	6.4
With general secondary education	30.3	25.6	34.8	33.8	27.7
With secondary specialised or vocational education	32.6	32.3	42.3	42.8	37.8
With basic or incomplete basic education	22.4	21.8	26.6	25.1	21.4

Source: CSB

As mentioned above, inappropriate education can be identified as a major cause for unemployment. The quality of general and professional education does not conform to the needs and demands of the national economy. Graduates of schools often have difficulty finding work even in those specialities where there are vacancies in the labour market, or they have learned trades where employment opportunities are few. The training of the unemployed is not sufficiently adjusted to the needs and demands of employers and abilities of the unemployed. A system for motivating individuals, employers and employees, to concern themselves with continued education and compensating for lack of education has not yet established itself in Latvia.

As regards the organisation of active labour market programmes, the Latvian authorities intend to give priority of involvement to people from disadvantaged groups. Such groups as disabled people, youngsters, long-term unemployed, non-Latvian speakers and pre-retirement age people have been recognised as disadvantaged in terms of labour market opportunities. According to the Ministry of Welfare, there are three main active labour market programmes to deal with integration of the unemployed into the labour market:

- *Vocational training, retraining and upgrading of qualifications.* In 2000, 10 267 unemployed persons were enrolled in a training course organised by the State Employment Service (SES). Of these, approximately 25% were young people, and 32% were long-term unemployed. The type of training provided is determined on the basis of labour market demand, as identified by SES. Of those who completed training courses in 2000, 66.3% found jobs.
- *Temporary Public Works.* This kind of activity is organised for unemployed persons who cannot find a suitable permanent job. In this case, the minimum wage is paid by the state, and the employer pays the social insurance contributions. In 2000, 9993 unemployed were involved in temporary public works. Of these, 9% were young people and 52% were long-term unemployed.
- *Job-seekers' clubs.* In 2000, 17 940 unemployed persons attended JSC activities, and 9 367 of these received more intensive assistance such as job-search training or instruction in the Latvian language. Of those receiving such intensive assistance, 33% were young people, and 28% were long-term unemployed.

It is recognised that there is insufficient access to active programmes, particularly for the young and for the long-term unemployed. For example, in 2000, training opportunities could be provided for only 36.6% of the 28 thousand unemployed people who expressed a desire to acquire a new profession or to upgrade qualifications.

In 2001, the SES started pilot projects related to in-service training of young persons, subsidised job places for disabled persons, and social enterprises for long term unemployed.

However, the existing labour market measures cannot cover all unemployed people in need. Such obstacles as the overall budgetary constraints are often quoted, however optimal targeting of programmes is also important. Programme expansion should support employability of the unemployed (human resources development and job-search support) rather than on the simple provision of temporary employment. The increasing designing of programmes in line with the needs of the labour market is a development in the right direction.

Low Quality Employment

Not only unemployment can lead to poverty and social exclusion. **Low quality employment** may have similar effects. According to the Household Budget Survey, even in the poorest decile, the vast majority of the economically active population has work, but their average expenditure per capita is remarkably low, especially in rural areas (in 2000, average expenditure per household member was 74.74 LVL in towns and 48.86 LVL in rural areas). Latvia, similarly to other countries of transitional economy, has a widespread „low wage poverty“ – earnings are often too low to ensure a subsistence level for even one person. The wage level in the national economy is influenced by the low productivity, high competition in the labour market and the level of wages in institutions financed from the state budget. The general level of wages is also affected by the set minimum wage (currently 60 LVL), which is below the minimum subsistence level.

Latvia is characterised by a large percentage of low paid jobs; working conditions do not always comply with labour safety requirements; violations of labour legal relations can often be observed. Often work is unstable and irregular “Grey” employment plays a major part here.

In towns and cities quality of employment is higher than in rural areas. Higher education ensures higher quality work, but people with a lower level of education usually are limited to lower quality work. The lowest quality work is done by those employed in agriculture. More and more farming is becoming a survival sector of low productivity with a very high level of part time and seasonal employment.

Gender discrimination in terms of remuneration constitutes a serious problem, especially in the private sector. In 2000, the average gross monthly wage in the national economy was 160 LVL for a male employee and only 126 LVL for a female employee. Men have a better chance to find well paid jobs than women, but wage differentiation for similar jobs can also be observed. In 2000, the first court case was initiated by a female employee

complaining about wage discrimination, and her claim was satisfied. Latvia's equal treatment policy is currently going through several stage policy planning process. Concept of Gender Equality was adopted in October 2001, and Action Plan for the implementation of the concept in 2002 was approved in March 2002. The next step would be National Gender Equality Strategy for years 2003-2007. In February 2002, it was decided to establish a Gender Equality Council, which would carry out co-ordination and advisory functions. A training programme on gender equality for civil servants has been launched.

Some employers fail to pay social insurance payments, as a result of which employees until recently could face problems at retirement, in case of sickness or unemployment. Constitutional Court has now ruled that the social insurance status of an employee shall not depend on the fact, whether contributions have actually been made by the employer. Much more often, however, employers in the private sector pay contributions only for a part of the real salary. This is the case even for well-paid, prestigious jobs. Many employers <roughly one third of the workforce is employed by employers affiliated to the Confederation> have failed to join the Latvian Confederation of Employers and in many businesses no institutions of employee representation have been established. They are not always able to properly defend the interests of employees. Often businesses fail to sign collective agreements. According to the Association of Free Trade Unions, only about 25% of employees in Latvia are covered by collective agreements, and hardly 20% of the workforce are union members.

The normative framework for combating gender discrimination, as well as other kinds of discrimination, has been introduced into the new Labour Law, which came into force on 1 June 2002. The eradication of such practises will however require further political resolve and administrative mobilisation.

The ministry responsible for labour market issues in general is the Ministry of Welfare, while the Ministry of Education and Science is responsible for all levels and types of education and training. The main strategic policy document on employment is the National Employment Plan (NEP), published annually since 2000. The structure of the NEP is based on the structure of European Employment Guidelines. Strategic objectives set out in the NEP for 2001 include „raising the skills of labour force“. Promoting adaptation of the labour force to a competitive and challenging environment with changing sectoral, occupational and regional structure of employment is a durable task. Overall economic improvement is an important contributor to progress in this respect, yet structural problems remain, as evidenced by the persistence of high unemployment and of regional imbalances in the labour market.

As regards combating discrimination and grey employment, its success heavily depends on the public trust in state institutions and the state social protection system. If they do not trust social guarantees provided by state,

they will prefer to be paid "in envelopes" and, most likely, receive low-level social benefits when the social risk occurs. Likewise, if the victims of discrimination do not expect their rights will be adequately protected, they are wont to tolerate the practise.

4.2.2 Guaranteeing Adequate Incomes/Resources

The level of **amenities** available in households varies strongly. The situation in rural areas is particularly worrying. In the table below, the percentage of households possessing given amenities is given for urban and rural areas:

Table 4.14: Household amenities in urban and rural areas (percentage of households reporting to have different items in use)

Item	Urban	Rural	Item	Urban	Rural
Electricity	100	98	Shower, bath	79	37
Water supply	92	52	Separate kitchen	96	97
Sewarage	92	49	Gas from network	67	-
WC	88	44	Gas from container	28	-
Hot water supply	68	18	Electric oven	3	2
Central heating	82	28	Telephone	75	43

Source: Ethnicity and Poverty in Latvia, Aadne Aasland, 2000

There is a significant regional variation. The highest average number of amenities in a household was found in greater Riga (6.7), the lowest in Latgale (3.8). As to the dwelling space, the national average is 22 sq.m. per household member. (Ethnicity and Poverty in Latvia, Aadne Aasland, 2000)

With regard to provision of basic subsistence necessities, no specific problems related to the Roma population can be observed in Latvia, as there are no nomadic Roma in Latvia.

Pension policy in Latvia plays a crucial part in guaranteeing adequate income to residents, as more than a quarter of the population receives old-age pensions. Due to the constant ageing of population, the importance of pensions (old-age pensions in particular) is predicted to gain in importance. Such provisions as the raising of retirement age and restrictions imposed on working pensioners slightly reduced the share of old-age pensioners in 2001 (504.8 thd or 26.8% of the total population at the end of 2001, compared to 27.1% a year earlier), still it was more than in 1999 (26%). These cost-saving amendments also temporarily halted the growth of pension amounts. However, following a recent ruling of the Constitutional Court that proclaimed restrictions for working pensioners unlawful, rise in pension amounts can be expected in 2002.

Since 1995, Latvian pension system has been undergoing significant changes (see Chapter 2). At the level of individual pension recipient, progress has been somewhat modest. The main indicator of growth is the increase in pension amounts, which manifests itself in the form of indexing. Increase, however, has not been large. The average old-age pension still remains considerably below the value of the minimum basket of goods, although the difference between these two indicators is steadily decreasing (see table below). 52.8% of old-age pensioners receive a pension amounting between 50 and 60 LVL, while 17.1% of old-age pensioners receive a pension of less than 50 LVL (CSB data).

Table 4.15: Average pensions and subsistence minimum goods and services basket

Year	1996	1997	1998	1999	2000
Average old-age pension (LVL)	38.30	42.55	51.57	58.92	59.76
Average disability pension (LVL)	39.20	42.81	50.86	54.70	53.98
Average survivor's pension (LVL)	32.20	35.94	42.17	46.82	46.05
Subsistence minimum goods and services basket value (LVL)	73.78	78.78	82.15	83.18	84.47
Average old-age pension as % of subsistence minimum basket value	52	54	63	70	71

Sources: Social Report 2001; Latvia Human Development Report 2000/2001

Authors of Latvia Human Development Report 2000/2001 point out: „Reform of the pension system has been more rapid than an improvement in the situation of pension recipients, partly because reforming a system requires much less financial resources than improving the general welfare of such a large group of population.“

Surveys show that even now Latvian pensions, although relatively small, provide a stable source of income and place pensioners in a better situation than other groups of the population. It has to be mentioned that the interests of old-age pensioners are continuously lobbied by some non-governmental organisations, among which Pensioners' Federation is the most active. Among other activities, it also carries out surveys of the social and economic situation of pensioners. In the publication „Self-estimated Social Situation of Latvian Pensioners“ (2000), the Pensioner's Federation claimed that around 40% of respondents had applied for social assistance at some point in time, and only 20% had received it. According to the survey, the most wide-spread problems encountered by pensioners were related to rent and utilities' payments (reported by 41% of respondents) as well as paying for health-care and medication (40% of respondents).

The negative effect of unemployment on the standard of living is emphasised by the limited level, coverage and duration of **unemployment**

benefits. Only a small share of unemployed persons actually receive an unemployment benefit. As one can see from the table below, the average amount of unemployment benefit is well below the subsistence minimum. It should be added that the levels of unemployment benefits show considerable regional differences. The benefits tend to be lowest in the Eastern region Latgale, and highest in capital city Riga. The short duration of unemployment benefits (9 months – see 2.3.9 for details) is a problem for the long-term unemployed. Marteen Keune in his research publication „Poverty and the Labour Market in Latvia“ comes to the conclusion that: „The low level and short period of entitlement to benefit, combined with the low number of recipients, ensure that the role of unemployment benefits, in preventing the unemployed and their households from falling into poverty, is very limited.“

Table 4.16: Unemployment benefits

Year	1996	1997	1998	1999	2000
Registered unemployed (end of the year)	95 421	86 531	112 990	111 102	94 448
Beneficiaries to unemployment benefit (average per month)	28 740	30 894	30 678	47 741	39 785
Average amount of unemployment benefit, LVL	27.77	30.38	40.08	48.07	45.30

Sources: Statistical Yearbook of Latvia 2001; Social Report 2001

It should be noted that until 2001, social guarantees provided by unemployment benefits envisaged an essential restriction. According to the law „On Compulsory Insurance Against Unemployment“, entitlement to unemployment benefit is conditional upon the fact that social insurance contributions have actually been made on behalf of the claimant for at least 9 months during 12 months preceding the insurance case. Employees whose employers have failed to make the required contributions are not entitled to a benefit. Considering the scale of „grey“ employment combined with the poor tax discipline in the Latvian business environment, this provision left significant numbers of people unprotected, even though there was little or no fault of their own in the fact that contributions had not been made. Ruling of the Constitutional Court of 13 March 2001 declared this provision unlawful. As a matter of fact, the law „On Compulsory Insurance Against Unemployment“ is yet to be amended to incorporate this provision.

What impact do state and municipal social benefits have on the poorest group of population? It should be taken into account that **state social benefits** are demogrants that are provided to specified groups of individuals who, due to objective reasons, have fewer options to gain income from work or who face increased expenses. State social benefits are flat-rate and are not means-tested.

The analysis of the impact of the most widespread state social benefits – family state allowance, child care allowance and the state social security benefit – on the income of the population allows us to conclude that these benefits have a significant impact on the poorest households. Results of the household budget survey show that, in 2000, households of the poorest quintile gained an average of 2.34 LVL or 9.9% of their total income per month from these benefits. The national average is 1.57 LVL, which corresponds to 2.3% of average income.

In single-parent families, state social benefits constitute 6.1% of the income, while the remuneration for salaried jobs provide 60% of the income. In households consisting of both spouses and their children, state social benefits form 4.9% of the income, while salaries constitute 77.1%.

In a research of child and family well-being in Latvia, CSB comes to a conclusion that the low size of state family benefits not only does not promote rise in the birth rate, but even, in a situation of unemployment, the insufficient amount of benefits causes serious problems for the budgets of families with children. Under such conditions, a large number of families with children have arrived at the risk zone (Trends and Indicators on Child and Family Well-being in Latvia, CSB, 2000).

Municipal social benefits are designed to provide support for the neediest part of the population. These are social assistance benefits, means-tested and conditional upon co-operation.

Household budget surveys testify that the municipal benefit system, as implemented at present, hardly complies with the criteria and objectives set by the law „On Social Assistance“. In 2000, support provided by municipal social benefits on average in the country is 0.23 LVL per month per household member (0.3% of income). In households of the poorest quintile, this support is below national average – 0.13 LVL (0.6% of income). It is obvious that municipal social benefits fail to fulfil their basic function – to provide support for the very neediest.

Instead, the system of benefits provided the greatest support to single-parent families – 0.59 LVL per month per household member (1.1 % of income). Nevertheless, it was still 2.8 times less than the previous year. Families with both parents received the smallest support from the municipal social benefit system – an average of only 0.07 LVL per month (0.1% of income).

The next largest group benefiting from municipal social assistance benefits is single-person households. For the most part, these are retired persons living alone. For people belonging to this group, municipal social benefits constitute 0.39 LVL per month (0.5% of income).

The number of cases where applications for benefits are rejected continues to grow. Municipalities justify it by lack of funds. As a result, increasing number of needy residents do not receive the necessary support.

Positive developments can be reported in the field of alternative **social care** services. In particular, the amount of home care provided to the elderly and disabled people has increased. In 2000, home care was provided to 6818 persons (compared to 6600 the previous year). 1 014 255 LVL or 22% of total municipal social assistance expenditure were spent on this service. Majority of applicants and 75% of recipients of home care are people of retirement age. The number of recipients of benefits for care showed a significant increase in 2000. In 1999, municipalities granted these benefits to 1979 persons. A year later, this number had almost tripled to 5608 persons (3505 of them – in Riga).

Rise in provision of care services, especially home care, looks promising for those groups of elderly and disabled people who depend on care. It enables them to retain their habitual life environment and to reduce the threat of institutionalisation. The increased amount of provided home care is a result of improved output of the social assistance system, although the demand for home care still considerably exceeds the capabilities to provide it. In Latvia, home care is strongly preferred to old people's homes, considering the low level of services and high degree of exclusion characteristic to the latter.

Over recent years, social care institutions for adults and for children have been paying more attention to improvement of the living conditions of clients and to providing better options for spending their leisure time. The main tasks identified in the organisation of operation of institutions, are to improve the living conditions of clients, to consolidate and develop domestic skills with the objective of returning the person back to independent life outside institutions.

4.2.3 Combating Education Disadvantage

In Latvia, a strong adverse link between the quality of education on one hand and poverty and social exclusion on the other can be observed. This inter-relation mainly operates through the labour market (see 4.2.1).

The relation between education and poverty has been more closely studied by Franziska Gassmann. In her book „Who and Where are Poor in Latvia?“ she comes to the conclusion: „The higher the educational level of the breadwinner, the lower the poverty risk [for the household].“ The largest increase in the poverty rate is observed comparing higher to secondary education. The majority of secondary education qualification held in Latvia are vocational. In many cases, these vocational qualifications, gained in the past, are over-specialised and not adapted to current and future patterns of

skill demand in the economy. In households where the breadwinner has primary education or not even that, the likelihood of poverty increases to more than 50% (with respect to the „medium“ income poverty threshold of 38 LVL). The risk of poverty is slightly higher for women in most education groups, however the impact of the level of employment on poverty risk seems to be equally spread to both genders.

As mentioned above, quality of education is an increasingly important factor. At the same time, a trend of commercialisation of education can be observed, which as a consequence makes access to education for children from poor families increasingly difficult.

The first contact of children with the education system is pre-school education. Below some basic indicators of developments in pre-school education in Latvia in the second half of 1990ies:

Table 4.17: Indicators of pre-school education

	1996	1997	1998	1999	2000
Number of pre-school establishments	611	598	586	573	561 (12 private)
Enrolment, thsd	72.3	68.4	66.1	65.1	61.8
% of children enrolled in pre-school establishments	43	45	48	53	52

Source: Statistical Yearbook of Latvia, CSB, 2001

As the birth rate in Latvia went down, both the number of children and pre-school establishments decreased subsequently. In the author's opinion, the overall growth in the share of children enrolled in pre-school establishments is due to changing patterns of family and labour market behaviour, as less and less parents could afford, or were willing, to stay at home and take care of their kids themselves, or hire someone to do that. On the other hand, the fee for attending pre-school education increased markedly over the last decade. In 1990, the average fee constituted approximately 4% of average salary, while in 1999 it was already 10%. Thus it can be concluded that a large share of families, especially poor ones, are facing difficulties to provide adequate care, in either way, for their children in pre-school age.

According to the data of Living Conditions Survey (CSB, 1999), 98.9% of school-age (7-16 years) children actually attended school. In the age group 17-21, this rate was 61%, while only 20% of those aged 22-26 were continuing education.

Primary 9-year education is compulsory, however there is a significant level of dropout, particularly in the later stages, and it is estimated that only 80% of pupils complete the 9-year cycle and "graduate" (National Observatory report, *The Modernisation Of Vocational Education And Training In Latvia, 2001*). Among the graduates, a substantial minority – estimated at one in six – achieve very low grades in the certificate examination.

Full-time education after the primary stage is provided at general secondary schools and at vocational schools. Entry to **general secondary education** is restricted to those who have graduated from basic education, and almost two thirds of such graduates follow this general education route, a proportion that has been rising steadily in recent years. The general secondary programme lasts three years, leading to a national certificate examination, success in which permits entry to higher education. Dropout rates in general secondary education are comparatively low, with approximately 90% of entrants completing the three-year cycle and graduating. Of those who graduate, approximately 60% enter higher education, 10% enter secondary vocational programmes and the remaining 30% leave full-time education.

The main issue arising in the initial education system is that a significant proportion of young people continue to leave school with few or limited qualifications, thus restricting the labour market opportunities of a notable share of students and subjecting them to increased risk of poverty and social exclusion later in life. This is related to the low level of attainment reached by a sizeable minority of children at the end of both primary schooling and secondary general schooling.

The government's plans to improve standards achieved by leavers from basic education and general secondary education are set out in the Concept Paper for Education Development 2002-2006. There are four main strategy directions, namely 1) quality improvement; 2) raising the effectiveness of the use of resources (raising teachers' salaries, reform of funding); 3) increasing accessibility (integrated system for the preparation of 5- and 6-year-old children for formal schooling, as well as enhanced remedial programmes in order to prevent social exclusion); 4) institutional development (improved management; investment in equipment).

There is no question about the desirability of these measures, particularly as regards raising quality of education. As already indicated, the importance of labour market demand in education policy has been recognised by policy makers, and it is important to proceed in this direction. However, building an education system that would be a real contributor to social inclusion, it is important to approach the situation in wider social policy context (see 4.3.2).

Many of the young people exposed to low level of attainment in general education establishments are admitted to the vocational education programmes. However, their lack of prior knowledge often hinders their ability to follow the vocational programme and many of them drop out because of poor progress in the studies, as well as belief that the training provided has only limited relevance to labour market needs. Shortage of funds is a major problem for vocational schools. They do not have funding to provide remedial courses for those who want to improve their basic knowledge. While overall spending on education in Latvia amounted to 6.8% of GDP in 2000, the spending on vocational education was only 0.8%, or 11% of total education budget. Relatively low salaries lead to difficulties in recruiting and retaining qualified teachers and instructors (to a lesser extent, this is a problem for the general education as well). Responsibility for different forms of vocational education is fragmented across a number of ministries, resulting in a lack of co-ordination between the state institutions involved.

There is obvious need to improve the relevance of **vocational education** to the needs of labour market, through more research on occupational demand, through better links with social partners, through appropriate curriculum development, through the development of national standards of occupational competence and accreditation and through alterations to the financing system to provide incentives for schools to respond to demand. Guidance and information system for students and parents, covering qualifications, possible pathways and labour market information, should be developed as well.

Important preparatory work for the implementation of measures to tackle the above-mentioned problems in the vocational education and training (VET) system was carried out under the Phare VET 2000 programme.

Continuing vocational education programmes are offered by state and local government as well as private providers and non-governmental organisations.

4.2.4 Family Solidarity and Protection of Children

Families with children were brought into focus of attention of the Latvian society and government institutions only after the first data of the household budget survey were published (in 1997), proving that the well-being of families with children was lower than of the households within another risk group, for example, pensioners' households.

The analysis of data on the disposable income of households of various demographic types during the period of 1998 – 2000 shows that **households with one adult and children** have the lowest income. It must be noted that during the whole period the average income of households with children has

been much lower than the average income of households without children. According to the data of the Living Conditions Survey (September 1999), 28% of the single parent families in Latvia could not afford meat, poultry meat or fish at least 3 times a week (compared to 20% of all households) and 27% of such families were unable to pay for their children's education (compared to 11% of all households). Single-parent families consisting of **mother and children** are subject to the highest poverty risk. The father often does not pay alimony to support the child (children) and the mother is facing serious discrimination at the labour market, forming a wicked circle of poverty.

A more detailed study of poverty concerning families with children has not been carried out in Latvia due to lack of comparable data over a longer period of time. (Trends and Indicators on Child and Family Well-being in Latvia, CSB, 2000).

In 2000, the average disposable income per household member of single-parent households was 53.42 LVL. At the same time, for example, the average disposable income of pensioners' households was 61.29 LVL per family member.

The trends in **poverty risk** faced by households of different composition is summarised by the available statistical data provided below. In this research conducted by CSB, data based on consumption expenditure were used. The lowest consumption expenditure poverty threshold (50% of national average consumption expenditure) was selected as the poverty threshold for the purpose of the survey. During the years covered by the survey, this threshold has been the following:

Table 4.18: Poverty threshold, Latvia, 1996-2000

Year	1996	1997	1998	1999	2000
50% of equivalent expenditure (LVL)	29.80	31.75	37.44	38.55	40.17

Source: Nabadzību raksturojošie rādītāji Latvijā 1996.-2000.g., CSB

In the table below, poverty risk index for certain categories of households is provided. Poverty risk index indicates what are the chances that an average household of the given group will find itself below the selected poverty threshold. Although fluctuations are high, certain trends are apparent.

Table 4.19: Poverty risk index by composition of household (average poverty risk index – 100)

Year	1996	1997	1998	1999	2000
Single-parent families	126	134	102	97	127
Households with 3 or more children	186	201	188	240	219

Source: Nabadzību raksturojošie rādītāji Latvijā 1996.-2000.g., CSB

As we see, the poverty risk is generally higher than average (with the exception of 1999) for single parent families, and considerably higher than average for families with 3 or more children.

The above-mentioned indicators may give an idea of the incidence of poverty among households of certain composition, but it fails to give an insight into the depth of poverty suffered by these households. In the table below, CSB data on the poverty gap index for different types of households are provided. This index represents the average gap (as a share of the amount chosen as poverty threshold) between the income of households in the given category and the poverty threshold.

Table 4.20: Poverty gap index by composition of household

Year	1996	1997	1998	1999	2000
Single-parent families	0.06	0.06	0.05	0.06	0.10
Households with 1 child	0.04	0.05	0.05	0.06	0.05
Households with 2 children	0.05	0.04	0.06	0.05	0.07
Households with 3 or more children	0.09	0.11	0.11	0.16	0.18

Source: Nabadzību raksturojošie rādītāji Latvijā 1996.-2000.g., CSB

Once again, the situation of families with 3 or more children is the most concerning. The poverty gap experienced by single-parent families is deeper than that of average households with 1 or 2 children, but even average households with only one child are facing a permanent poverty gap of around 5%.

On the one hand, the disadvantaged situation of households with children can be explained by objective macroeconomic factors and to a certain extent, especially regarding households consisting of a single mother and child(ren), by the jungle law of the labour market. In such circumstances, family dissolution becomes a significant, albeit indirect contributor to poverty.

Table 4.21: Marriages and divorces (per 1000 capita)

	1996	1997	1998	1999	2000
Marriages	3.9	4.0	4.0	3.9	3.9
Divorces	2.5	2.5	2.6	2.5	2.6

On the other hand, it is apparent that family benefits do not provide sufficient support for families with children. Just like most other fields of social protection, the state family benefit system is in the middle of transition.

Although state family benefits generally form a small share of the household income structure, their importance is nevertheless high for low-income families (see 4.2.2).

State policy on family benefits has been at the heart of some controversy in recent years, in particular a transitional provision establishing different treatment for children who were born before 1 January 1999 and after that. This cost-saving move was introduced to ensure a gradual transition to the new (slightly more generous) system, but in practise it means that families are granted smaller amount of state family allowance for children born before the given date. The hope that such a move would contribute to raising the birth-rate proved short-lived. Birth-rate slightly increased in 1999 and 2000, but in 2001 it went down again – for the first time in several years.

4.2.5 Accommodation

A significant number of **homeless people** is present in Latvia, however their exact number is unknown. Homeless people are often without identification papers and, by definition, without a registered place of residence. As a result, from the perspective of statistics and, most often, public policy in general, they are officially non-existent. The highest concentration of homeless people can be observed in Riga. State provides asylums for homeless people, however, the capacity of these asylums is far too short, especially for men, and people without a passport are not admitted there. Data of Social Assistance Fund testify that in 2001 services in night shelters were used by 1647 persons (from these 1556 cases were dealt with in major cities). Homeless people have to rely on churches, charities etc. for food. Begging is one of the most widespread coping strategies adopted by homeless people.

A growing problem for a large part of the population is constituted by the ongoing **deterioration of their homes**. Neither municipalities, nor most private landlords are willing to put money into capital repairs. Poor quality pipes and joints result in frequent plumbing problems and a frequently interrupted water supply. (Listening to the Poor – Social Assessment of Poverty in Latvia, 2000)

The disparity between income and the amount of **rent and utilities payments** constitutes a serious problem for a large share of population. Inability to make the payments in full or at all is widespread. It should be noted that this problem has an ethnic dimension, however it seems to be related to different coping strategies rather than differences in income level (see also 4.2.6). In a survey, 7% of Latvian and 13% of Russian respondents claimed they had not paid rent for the past 3 months, while 12% of Latvians and 20% of Russians said they only paid rent and utilities payments partially (Ethnicity and Poverty in Latvia, Aadne Aasland, 2000). According to the Household Budget Survey, the poorest households actually spend a lesser

share of their consumption expenditure on rent and utilities payments than households of medium resources. This can be explained by the fact that the poorest households often don't pay the bills (all or part) or are excluded from using certain utilities, e.g. heating is turned off in their homes.

For many people the cost of monthly rent and utilities payments exceed their salaries, although the exact number of such persons is hard to estimate due to unreliability of reported income data. However, there seems to be little doubt that the high price of utilities is an important contributor to poverty, especially in large families where one or more adult is unemployed, or for persons of small income (e.g. pensioners) who live alone in large apartments with all amenities. People whose income state has deteriorated during the last 10 years often find themselves in a situation where they cannot afford their apartments. If such persons apply for social assistance, they may be asked to find a dwelling corresponding to their resources first, which is often a problem.

People who are heavily indebted risk losing their social status. If they do not apply for social assistance or apply and are not granted sufficient help, they may even risk becoming homeless. A worrying trend is the growing activity of estate dealers (often illegal) who trick heavily indebted persons out of their homes. Such activities are especially widespread in Riga. As a result, the tricked people may find themselves on the street or in low-quality dwelling in a particularly run-down residential area (see 4.2.7).

A recent attempted solution, targeted at the people who cannot afford to pay rent and utilities payments, is the so-called 'social houses' financed by municipality. They provide apartments of reasonable quality to specified categories of claimants (e.g. pensioners) for symbolic price. However, the capacity of existing social houses is by far insufficient to solve the entire problem. Municipalities act (or don't act) in line with their individual capacity. The city of Riga has been most active in this respect.

4.2.6 Ethnicity

The interrelation between poverty and ethnic nationality in Latvia has been most closely studied by Aadne Aasland. In his book „Ethnicity and Poverty in Latvia“ (2000), he comes to the conclusion that there are no substantial differences between ethnic groups with regard to the percentage of people living under the (different) poverty lines. 4 poverty thresholds were selected. The study conducted in 1998 found that 12% of Latvians, 11% of Russians and 14% of other nationalities' representatives were living under the lowest income poverty threshold (50% of average expenditure or 27 LVL per month). Only 23% of Latvians, 19% of Russians and 22% of other nationalities reported an income that exceeded the highest selected threshold („subsistence minimum“) – 88 LVL.

The importance of such factors as gender, age and education is spread equally along the different ethnic groups. At the same time, the urban/rural dimension showed some peculiarities. It turned out that the income gap between urban and rural residents was deeper among Latvians than among Russians. Only 25 % of Latvians residing in cities were below the minimum wage poverty threshold (42 LVL), compared to 46% of rural residents. For Russians, these numbers were 31 % and 42 % correspondingly.

Some non-monetary indicators of well-being uncovered more patterns with an ethnic dimension. For instance, the average level of household amenities in Russian households appeared to be considerably higher than in Latvian households. This can be explained as a lasting effect of the housing policy practised in the Soviet era, when large share of the newly constructed dwellings were allocated to migrant workers from other parts of USSR.

It should be noted that the subjective attitude of individuals towards the changes in their financial situation since Latvian independence is heavily influenced by their ethnicity. In the survey, respondents were asked to compare their present well-being to that in 1991. The prevailing attitude in all ethnic groups was negative, but ethnic minorities were much more critical of their present state. Survey also showed that ethnic minorities generally felt more affected by economic insecurity. Among ethnic Latvians, feeling of insecurity was greater among rural population, while for Russians and other ethnic minorities it was vice versa.

The survey showed that ethnic groups differ in terms of strategies of coping with poverty. Ethnic Latvians reported greater involvement in all kinds of activities for own consumption – agricultural activities, handiwork etc. On their part, Russians and other minorities are more often looking for different cost-saving opportunities. They also reported greater debts, including debts of rent and utilities payments (see 4.2.2).

Overall, no significant ethnic dimension can be observed in the actual poverty situation. At the same time, one of the main risk groups for social exclusion are unemployed people. With regard to unemployment, clear ethnic divide can be observed, which is explained mainly with the lack or insufficiency of language skills of many non-Latvians. According to the Population Census 2000 the level of job seekers in the age group 15-64 is 12.7% for people with Latvian language skills and 20.8% for people without Latvian language skills. Other factors include the impact of the economic restructuring on the sectors supplying Soviet military complex - electronics, heavy industries - which employed the labour force immigrated from the territory of the former USSR, especially during the last decades before the transition. Possessing education and skills necessary in the above mentioned specific sectors, these persons faced difficulties when re-integrating into labour market. Study “Occupational Representation and Ethnic Discrimination” by Latvian Centre for Human Rights and Ethnic Studies (2002, with the support of Soros Foundation – Latvia), which was first of its

kind for Latvia, comes to the conclusion that no widespread or systematic discrimination can be observed on the labour market. However, the issue calls for further research and analysis.

The unemployment gap between Latvians and non-Latvians, as shown in the LFS, is not fully reflected in the data on registered unemployment: by mid-2001, the registered unemployment rate in SES stood at 7.5% for Latvians and 9.7% for non-Latvians.²

Take-up of social assistance services also reflected ethnic division. Latvians were generally better informed about social assistance and received social assistance benefits (both in cash and in kind) more often than other ethnic groups. However, the percentage of persons who had applied for social assistance was similar for Latvians and Russians. Some other indicators also witness that preferential treatment of ethnic Latvians is practised by social assistance services. 73% Latvians, 59% Russians and only 50% other nationalities' representatives who had applied for social assistance were granted the requested benefits in full. 11% Latvians, 20% Russians and 30% other nationalities received nothing. It also appears that applications by Russian claimants take a longer time to review. (Aadne Aasland, *Ethnicity and Poverty in Latvia*, 2000)

Knowledge of Latvian language is important for access to higher education and labour market opportunities. Poor knowledge of Latvian is considered the key reason behind the higher unemployment rate among ethnic minorities. To address this problem, language training for the unemployed has been introduced. Language training is provided within the framework of Job Seekers Clubs and it has also been integrated within vocational training courses for the unemployed. The language of instruction at school is a key factor, influencing the knowledge and future labour market opportunities of students. At the moment, the state is still providing general secondary education both in Latvian and Russian, but a switch to secondary education only in Latvian is scheduled for 2004. Advocates of this move claim that it will contribute to the general knowledge of Latvian among non-Latvians and thus (beside strengthening positions of Latvian language, which is *raison d'être* of the reform) improve the situation of ethnic minorities. On its part, opposition holds the opinion that inability to attain education in the native language will adversely effect the knowledge and, subsequently, labour market opportunities of Russian-speakers.

² The fact that there is no poverty differences to match the unemployment rate differences might have several dimensions. First, it is possible that Russians have stronger informal support structures – a recent study on occupational representation and ethnic discrimination by Latvian Centre for Human Rights and Ethnic Studies (2002, with the support of Soros Foundation – Latvia) indirectly points to that. It is also likely (although there is no hard evidence) that Russian-speakers are more often engaged in illegal employment. Then, there is a trend, proved f.i. by political opinion polls, that Russians are more reluctant than Latvians to give sincere answers in surveys.

4.2.7 Regeneration of Areas

Throughout this chapter, the author has tried to accent the urban/rural and regional dimensions of poverty in Latvia. Here the main points witnessing importance of these dimensions in Latvia will be summarised.

The income situation of households according to the urban/rural and regional dimension is provided in the table below.

Table 4.22: Disposable income per household member, LVL per month

Year	1996	1997	1998	1999	2000
All households	51.50	55.45	62.33	64.73	69.19
Urban households	53.11	57.80	67.26	70.93	76.69
Rural households	47.71	49.86	51.40	50.93	52.13
By region					
Kurzeme	49.49	51.51	54.07	57.43	59.85
Zemgale	51.03	55.04	57.06	56.49	62.78
Latgale	44.49	44.76	45.54	49.30	48.94
Vidzeme	47.82	51.63	55.88	57.79	62.29
Greater Riga	55.81	61.64	73.98	76.37	82.76

Source: HBS, CSB

The economic recovery that Latvia experienced in the second half of the 90ies primarily affected the economic situation of urban households, while the improvement in the income situation of rural households has been limited indeed. The income gap between urban and rural residents has increased, and so has regional differentiation. Although all regions show an improvement towards the end of the 90ies, Riga and the Eastern region Latgale remain strongly seated at opposite ends of the ranking. The remaining 3 regions form a conditional „middle class“.

In 1996, when the Household Budget Survey was launched, the Gini coefficient was higher in urban population (0.30 compared to 0.27 in the countryside). Since then, however, the stratification of rural households has caught up, and in 2000 the coefficient was 0.33 for both urban and rural households. Of course, the Gini coefficient does not describe poverty directly, however an increasing Gini coefficient may witness that the economic situation in the society is favourable for spread of poverty, especially if the average income level is low or income development of the needy segments of population is inadequate to the general national development.

Poverty risk index calculated by CSB may prove valuable to demonstrate the comparative **poverty risk** faced by rural households and households in the depressed Latgale region.

Table 4.23: Households' poverty risk index (average poverty risk of the whole population – 100)

Year	1996	1997	1998	1999	2000
Rural households	117	130	151	174	175
Households in Latgale (urban and rural)	123	133	163	135	170

Source: Nabadzību raksturojošie rādītāji Latvijā 1996.-2000.g., CSB

Beside the axiomatic conclusion that poverty risk is considerably higher in rural households, this indicator stresses the growing wealth gap between urban and rural residents. The same is true for the population of Latgale, which is hopelessly lagging behind other regions.

At present, regional development matters are the competence of several ministries and agencies. With a view to reducing the complexity of these arrangements, the Cabinet of Ministers in December 2000 decided that there was a need to establish one national institution to deal with regional development issues. However, implementation of this decision is being examined in the context of Latvia's preparations for administration of EU structural funding; as a result, no decision has been taken as yet on which national institution should take on overall responsibility for regional development. Early implementation of the government's decision would improve co-ordination of planning between the national, regional and local level institutions.

Elaboration of specific policies in support of regional and local development began in 1996. A law passed by the Parliament (Saeima) in 1997 provided for the identification of "specially supported regions". In 1998, 112 territories applied for this status, and 84 territories had their applications approved. The approved territories had a combined population of 373,000 or 15% of the national population. Decisions on granting "specially supported region" status were made by the Cabinet of Ministers, based on a combination of a) objective social and economic indicators and b) the quality of development plans submitted by the local government. By the end of 2000, the number of territories having applied for "specially-supported region" status had risen to 143, and 135 of these applications had been approved. Around 90% of all administrative territories in the Latgale region are approved for special status.

The main instrument for the development of the specially supported territories is the Regional Fund. The task of the Fund is to favour entrepreneurship in these territories by financing projects, both private and public, that generate employment and promote growth of living standards. Apart from direct financial support for projects, there is also an

information/education programme aimed at entrepreneurs and local governments.

In 1998 – 2000, 585 projects have been approved involving planned investment from the Regional Fund in the specially-supported regions of LVL 5.7 million (equivalent to 15.57 LVL per capita in these regions.). Average planned investment per project is LVL 9,723, and the average planned project-implementation period is three years. To date, approximately LVL 2 million of the planned investment has actually been utilised.

According to information provided in project submissions, it has been planned to create 3,836 new jobs. To date, 1,899 permanent jobs and 1,614 seasonal jobs have been created by projects that have actually commenced. In addition, it is estimated that assistance from the Regional Fund has allowed 3,200 job places to be maintained that would otherwise have been eliminated.

On average, each local authority has submitted approximately 3 projects. The level of project submission, and the trend in this level, varies widely across districts. For instance the number of projects submitted has been rising in the district of Preili (40 projects in 1998, 61 in 1999, 74 in 2000), but falling in the district of Ludza (26 in 1998, 8 in 1999, 7 in 2000).

The main reason identified for the fall in project submission is the insufficient capacity of local institutions and entrepreneurs to draft proper project proposals and to deal with institutional procedures. To address this, 7% of the Regional Fund is allocated for the purpose of increasing the regional capacity of local governments and entrepreneurs in business management, project drafting, business plans and exchange of experience. Around 30 information centres have been created in regions (50% of expenses are covered by the Regional Fund, 25% from the budget of local authorities and 25% from other sources) to provide advice for entrepreneurs on business management, project procedures and other institutional procedures in country.

Another concern is people who lose their homes and are forced to move to low-quality dwelling in a particularly run-down residential area. The problem has been highlighted in mass media, but no systematic inquiry has been done in this direction. A kind of „poor people’s ghettos“ are starting to form in some parts of Riga and nearby settlements.

The case of Karosta neighbourhood in the port town Liepāja has received special attention. This residential area had developed around a Soviet military port, and after departure of the Russian army and breakdown of the established infrastructure quickly became a ghost town with high criminality and very poor living standards. On these grounds, a Special Economic Zone

was established in the area, and ambitious development plans are being drafted, seeking to attract financing from ISPA and other sources.

4.2.8 Other factors influencing poverty and social exclusion

Access to health-care is a major problem for the neediest segments of the population. Health-care system in Latvia is partially tax-financed, however it implies patients' co-payments – a burden that many patients can hardly afford. According to the results of Household Budget Survey, the share of health-care expenditure in the overall consumption expenditure of the household is proportional to the wealth of the household. In 2000, households of the poorest quintile spent only 2.6% of their consumption expenditure on health, compared to a national average of 4.2%. In the long-term, such a coping strategy inevitably leads to deteriorating state of health, lower life expectancy etc. For people of working age, poor health means higher incidence of disability or reduced earning capacity, forming a wicked circle of poverty.

Already today, the unhappy Latgale, with a very high unemployment rate, constitutes a grave example. In Latgale, the level of disability is twice higher than average in the country. To some extent, it can be explained by the fact that unemployed people are more active in seeking for disability pensions than the employed. But surveys show that the health conditions of inhabitants of Latgale are objectively worse than those of other regions. The life style is also unhealthy: in the region, the use of alcohol is much higher than in other regions. All this results in lower life expectancy.

The municipal social assistance envisages compensation of health-care expenses for needy patients, however in practise the system fails to fulfil this function, particularly in poor municipalities. The ever-present shortness of funds is the problem.

Situation of **mentally ill patients** gives rise to concern. Despite the fact that this issue has repeatedly been stressed by the European Commission, no developments in this field can be observed as yet. Situation in many care institutions remains sub-standard, while alternative care services have not been sufficiently developed. Every year, the number of patients at state-financed specialised care institutions increases slightly. As a rule, all places are filled and patients have to wait to be admitted. Since the alternative to these state-financed institutions is care at municipal nursing homes, municipalities are financially interested in placing patients in state institutions.

The Social Report 2001 by the Ministry of Welfare puts forward general proposals for improving the situation of mentally ill patients. Thus, the state should provide support to the development of alternative care services through municipalities. Principles for the funding of social care institutions

should be changed, reducing the interest of municipalities in placing clients in state specialised social care institutions when their needs would be better satisfied by care services provided at their place of residence or nursing homes.

There are no data that would allow us to quantify the poverty risk for such obvious risk groups as drug and alcohol addicts and former inmates. Persons who have been recognised as addicts are treated for addiction free of charge. As regards former inmates, the stigma attached to this status seriously hinders their chances to establish themselves on the labour market, thus increasing poverty risk and, often, force them back into criminal practices. Data of the Prison Administration suggest that approximately 40% of former inmates are return to prison.

4.2.9 Administration, Access to and Delivery of Services

The decentralisation dimension is one of the key aspects that should be taken into account in order to understand how policy measures aimed at combating social exclusion work in practise. The legislation in force allows municipalities considerable freedom in setting criteria and awarding social assistance benefits. Spending on education, health and public services thus competes with spending on social assistance. As a result, the majority of local governments interpret the law „On Social Assistance“ with a considerable degree of arbitrariness. It has even been argued that each local government implements a „**different benefit system** with different purposes and priorities“ (Social Report 2001). The recent GMI concept contains provisions aimed to right the situation (see 4.1.1).

World Bank in their assessment of poverty situation in Latvia observe that social assistance offices tend to deny assistance to households with more than one adult male or headed by an unemployed person (Republic of Latvia Poverty Assessment, Volume I, 2000). The latter is a particularly worrying observation, since unemployment is by default a major contributor to the poverty risk.

The decentralised organisation of social assistance inevitably leads to significant inequalities with regard to the level of benefits and services provided by municipalities, especially considering the wealth gap between different regions of Latvia. The present model makes municipal benefits directly dependant on the financial well-being of the municipality, and thus contributes to the significant regional and urban/rural differences in terms of poverty risk described earlier in the report. With the exception of a few relatively richer cities, most local governments (especially in rural areas) have been constantly voicing their protest against the discrepancy between the social burden imposed by the law and their limited resources. Remembering what was said before about the freedom of choice allowed for municipalities, it becomes apparent that the actual allocation of municipal

social benefits is strongly influenced by considerations other than effectiveness of social protection. According to a CSB research carried out for UNICEF, „local governments often use different poverty lines, mostly depending on their financial feasibility“ (Trends and Indicators on Child and Family Well-being in Latvia, CSB, 2000).

The existing inequalities are exemplified by the capital city Riga, which hosts more than a third of Latvia's total population and is one of the richest municipalities *per capita*. While most municipalities are struggling to guarantee claimants 75% of „crisis subsistence minimum“ (i.e., 28.67 LVL), the city of Riga, for the purposes of awarding death grants, relief of housing debts and home care, considers the statistical subsistence minimum of 86.93 LVL as the threshold below which households are entitled to these benefits. For other benefits, the line is drawn at 75% of this amount (65.20 LVL) for single-person households, 65% (56.50 LVL) for two-person households, and 50% (43.46 LVL) if the household has three or more members. (Once again, this provision embodies the prevailing attitude towards single – presuming single elderly – people as the neediest and most deserving clients of social protection.) On 12 February 2002, Riga City Council approved its own list of indicators for awarding the status of a low income person.

Surprisingly, in the Western region Kurzeme, with the second lowest average personal income level in the country, every resident receives, through municipal benefits, the same support as in Riga region, where the income level per capita is the highest. The only viable explanation of this phenomenon is that municipalities in Kurzeme are more active in granting services and advertising their activities. The above two regions are the only where municipal social benefit income per household member is higher than the national average. In the region with the lowest per capita income – the Eastern region Latgale – residents receive the lowest support through municipal social benefits – more than two times lower than the national average and almost three times lower than in Kurzeme.

Benefits for care demonstrate a more profound gap between Riga and other regions. Out of a total of 5608 benefits for care granted in 2000, 3505 were granted in Riga.

Municipalities often practice the payment of benefits „with a transfer payment for a service“ thus indirectly subsidising specific types and providers of service, among them those who should receive funding from other resources. (Social Report 2001)

As far as the influence of NGOs in the development of social inclusion policy is concerned, a survey conducted by the editors of „Latvia - Human Development Report 2001“ shows that the involved experts estimate the role of NGOs as irrelevant and stating „their possibilities to influence political decisions are close to zero“. But one can observe positive signs during 2001. The NGO Centre was invited to participate in elaboration of

draft law „The Procedure of State Administration“, representatives of NGO Centre were allowed to participate in meetings of state secretaries of all ministries where new draft laws under preparation are announced.

In the social field, Pensioners' Federation and the organisations of disabled and handicapped persons are most active among NGOs. The NGO Centre in the framework of project „Stop The Dependency“ offers assistance for preparation of projects for elderly NGO activists.

People traditionally address their **complaints** regarding social protection services to the Ministry of Welfare. However, only in few exceptional cases the Ministry carries out a conventional examination itself. Claims are commonly re-addressed for examination, in accordance with their competencies, to the State Social Insurance Agency, Social Assistance Fund and other organisations subordinated to the Ministry of Welfare. Court litigation is available as a final remedy. Taking into consideration financial conditions of the claimant, the court may reduce the amount of payment of costs. If the decision is taken in favour of the claimant, costs are paid by the respondent.

4.3 Evaluation of future challenges

4.3.1 Main challenges

In the author's point of view, the primary challenge for a successful social inclusion policy in Latvia is breaking the existing patterns of attitude at all levels – political, administrative and general public.

At the political level, it first of all implies that high level of poverty should not be perceived as a „natural“ side-effect of economic transition, which will automatically disappear at some point in time, when the economic situation improves. Policy-making should take account of the fact – the deeper inequalities in the population, the greater anti-social consequences they will generate. In recent years, positive developments can be noted in this direction. Social exclusion and poverty have in principle been recognised as problem areas, and policy measures aimed at combating these problems is being developed. It is important to continue with policy development in this direction and, at the administrative level, to implement the measures consequently and efficiently.

Another key challenge for the administration is to get rid of the stereotypes and bias prevailing in implementation practises, especially as regards municipal social assistance institutions, who are in charge of most practical issues in the field of social inclusion. Strict criteria of allocation is an important political back-up for changes in the right direction, but it is important to keep in mind that this issue should be viewed not only in terms of normative base and institutional capacity, but the dimension of attitudes should be taken into account as well.

Finally, the public should be made more aware of its rights and encouraged to defend them. As long as the jungle laws of labour market are tolerated by the victims, no far-reaching improvements can be achieved from above.

4.3.2 Links to other social protection policies

Several lines of social protection reform are important for the situation around social exclusion and poverty in Latvia. Pension reform (see Chapter 2) is among them. The legislative framework of the new system is already in place, but the true effect of the reform will manifest itself in the future. The re-distributive and equalising effect of the pension system is diminishing, as the individualised, insurance-based provisions one by one come into force. In the new design pension system, re-distributive arrangements of solidarity are restricted to the first tier, which will gradually lose its importance as the pension funds mature.

The system of family benefits is under reconstruction as well (see 4.2.4). The importance of family benefits could hardly be overestimated, considering the grave situation of families with children in the Latvian socio-economic environment, and the high risk of social exclusion and poverty for such families.

Finally, the reform of the municipal social benefit system, in particular, the introduction of GMI is of highest importance for the very neediest segment of population.

It is easy to see that these different fields of the social protection system are closely interrelated. At the moment, labour market opportunities and family benefits fail to provide sufficient support for many families with children, social assistance benefits are awarded to such families in order to compensate, at least partially, this deficit, and the very neediest social assistance claimants only get a leftover of the already tight funds. Concerted action on the highest social policy level is required to break this chain.

As far as access to education is concerned, the opinion of the author is that real success in this field can be achieved only if the problem is approached in a wider social policy context. For instance, integrated pre-school preparation is very good, but as long as many families cannot afford it, the gap between haves and have-nots in the society will only deepen. Therefore, in the course of policy-development it is important to pay tribute to the close link between education, social benefits for families, rights and opportunities of parents on the labour market and other factors.

4.3.3 Political directions of future reform

On July 17, 2001 the Cabinet of Ministers approved the Long Term Economic Strategy of Latvia. The strategy identifies the goal to achieve the level of welfare of population matching standards of the developed countries in the nearest future as the main task of state economic policy. To implement this scenario, Latvia should put an end to the currently dominating economic model, characterised by use of cheap labour. The most realistic way of developing national economy is intensive use of knowledge and high technologies, reorientation from labour-intensive economy to knowledge-intensive economy.

Closer to earth, it is crucial to build on the recent developments in policy aimed at combating social exclusion and poverty. The adoption of the Poverty Reduction Strategy was an important step, however the follow-up is still pending in the pipeline. An Action Plan based on the Strategy was turned down by the Government, and the future design of the implementation mechanism at the moment looks blurred.

In the labour market policy, following areas remain topical for the next years: the enhancement of the quality of the labour force, the promotion of employment among young people, the reduction in the length of unemployment, the formulation of special employment programmes for the integration of the unemployed of pre- retirement age into the labour market. The last measures are relevant in the demographic context and taking into account the rise in retirement age. Furthermore, in the year 2005 the possibility for early retirement will be abolished. The use of active employment measures is on the increase.

In the field of family benefits, the differentiated treatment turned out to be unpopular. For some years now, there has been widespread public demand to change that, which finally echoed in the political circles. As a result, new amendments are under preparation. The aim is to get rid of the differentiated treatment. According to the draft amendments, state family allowance for children born before 1999 will be gradually raised over a 3 year period until it reaches the level of the other group.

4.3.4 Social exclusion, poverty and EU accession

In Latvia, great hopes are attached to the expected economic improvements after joining the Common Market. In the author's point of view, one of the main frailties of Latvian public policy is the perception of EU membership as ends, not means an automatic solution of all problems rather than a set of opportunities that should be used in the right way. Very much will depend on the speed and efficiency with which Latvia will adapt to the economic and social consequences of accession. Policy measures aimed directly at

combating social exclusion and poverty must be developed, and the capacity of implementing institutions must be raised accordingly.

It will be of particular importance, whether Latvia will manage to use the structural funds with the maximum efficiency. One should not forget that the first pre-condition for that is a stable and effective domestic policy, and only under such circumstances EU membership can really fulfil the promise.

It can be predicted that the poorest segment of population will feel the benefits of accession less than others. Their mobility is lower and they are likely to be less affected by the free movement of persons, although much will depend on the final terms agreed by EU and Latvia. Alignment with the free market requirements will have considerable side-effects for the material well-being of especially the poorest part of the population, for instance, through introduction of value-added tax for utilities and drugs. As pointed out in the report, these costs are already a heavy burden for the poorer segments of society. As far as the impact of social security on the poverty situation is concerned, in a Europe of non-harmonised social security it will not be directly affected by accession.

The accession negotiations have already made an impact on Latvian social policy with regard to social exclusion and poverty. The attention paid to social exclusion issues in negotiations and in the *Acquis Communautaire*, along with activities of other international actors, have finally triggered the development of some sort of national poverty reduction policy. A related issue that will hopefully have a strong influence on the national policy implementation following accession, is Equal Opportunities. As mentioned in this report, so far discrimination, in particular discrimination of women on the labour market, has been a major problem and a factor contributing to social exclusion and poverty in Latvia. The legislative framework, providing for equal opportunities, has already been introduced – in line with requirements of *Acquis Communautaire*. Hopefully, the responsibilities of a Member State will mobilise Latvian policy makers and administrators to achieve adequate implementation of the provisions.

4.3.5 Conclusions

Social exclusion and poverty constitute a serious problem in Latvia.

Several basic **factors** can be identified. First of all, there are "objective" or "external" (i.e. originating outside the social protection domain) factors. The lasting effects of the severe economic decline of early 90ies and the hardships of a transition economy have resulted in socio-economic environment, where large parts of population find it hard to uphold a decent standard of living. Significant regional and urban/rural differences can be observed, contributing to particularly high poverty risk for rural population and population in the depressed Latgale region.

High unemployment rate is one of the outcomes of the economic decline. At the same time, labour market patterns uncover a set of specific labour market factors contributing to social exclusion and poverty. Those are high incidence of long-term unemployment, discriminatory practises and poor quality employment. The latter two are characterised by a clear gender dimension - risks for women are considerably higher.

Social protection is by definition designed to provide guarantees where market has failed. In Latvia, the social protection system does not always fulfil this function to such a level as to safeguard individuals and households from slipping into poverty. In some cases, benefits are insufficient or implementation practises - inadequate.

One can differentiate between several **risk groups**. The most proclaimed risk group includes persons relying on the generally modest social protection benefits as the main source of income, first of all, pensioners. Another generally disadvantaged group is families with children.

Some categories of families with children face a particularly high risk of poverty and social exclusion. Those are families with 3 or more children and single-parent families, most of all, single mothers. Women generally face a higher poverty risk than men, which can be explained with their disadvantaged situation on the labour market. Regional differences also remain high.

Individuals who have slipped deep into poverty, have little chance of recovering a higher social status. The implementation of social assistance system is currently focused on helping persons who are supposed to belong to perceived risk groups, and neglects the very neediest. Finally, an unknown number of homeless people are living in Latvia, whose chances of re-integration into society are close to zero.

Overall, poverty and social exclusion in Latvia have clear-cut regional, gender and what the author would call “family” dimensions. The latter is particularly worrying. Raising children is always a financial burden, however the society is responsible for relieving this burden for its members to such an extent that would enable a vast majority of economically active population to undertake it without risking their social status. The relationship between family burden and poverty risk shows that this is not the case for Latvia.

The system of social transfers has been compromised by hardships of transition economy and policy priority judgments. While in macroeconomic terms Latvia is recovering at a rapid pace, indicators such as Gini coefficient et al. suggest that the inequalities in the society are growing, both overall and between regions. The targeting of social assistance benefits is somewhat disproportionate. World Bank analysts have pointed out that, in comparison to other transition economies of the region, Latvia’s social assistance is

“extremely modest in size, yet concentrated”. Very few households (1.5% in 2000) receive social assistance, and it accounts only for 0.29% of household expenditure. At the same time, those who received social assistance after all, got an average of 45\$, which is quite good against regional background. (The Republic of Latvia Poverty Assessment, World Bank, 2000)

Until recently, there was no official **policy response** to the problems of poverty and social exclusion. Social inclusion was not recognised as a priority area. To a large extent, this was related to the attitudes prevailing in political circles as well as in general public. There is no uniform set of poverty criteria.

However, in recent years, recognition of the poverty problem has resulted in drafting of a series of initiatives and policy planning documents, targeted at poverty reduction, employment, equal opportunities, regional development and other areas. It is important to proceed with implementation of practical measures, inter alia, via efficient utilisation of resources offered by structural funds. As regards targeting of social transfers, the most important recent development is the introduction of Guaranteed Minimum Income. Hopefully, it should reduce the poverty risk for the least protected members of the society. As far as the modest overall financing is concerned, it is once again an issue of determining political priorities.

It should be noted that, although the society of Latvia is ethnically mixed, no substantial ethnic dimension could be identified for poverty situation. Some differences in employment and behavioural patterns have been uncovered, however they don't result in significantly different poverty risks.

A few words have to be said about the possibilities of reliable assessment and measurement of poverty and social exclusion in Latvia, which is a vital pre-condition for policy development and research alike. Such factors as unreliability of data, particularly regarding income of individuals, as well as survey results, make it hard to draw an objective picture of the situation. The statistical system, which plays an important part in poverty assessment, is also experiencing changes. At the moment some vital parameters (e.g. relating education to poverty risk) are not available.

5. HEALTH CARE

5.1 Evaluation of current structures

5.1.1 Organisation of the health care system

Government policy distinguishes between primary, secondary and tertiary health care. Patients normally enter the health care system via the primary sector by visiting a first-line or out-patient care or general practitioner - the family doctor, an intern or a paediatrist (the primary health care intern or paediatrist provides primary health care services only during the transition period until the optimum number of family doctors is reached).

The primary health care is directed towards the society as a whole and each of its members individually. It should be accessible, well understood and effective. It is difficult to separate health promotion and preventive activities from primary health care - prevention, diagnosis, treatment and rehabilitation at the individual level are delivered in out-patient conditions because part of these activities are strongly interrelated.

The relationship between the recipient and provider of the primary health service is regulated by the law "On Medical Treatment" (effective from July 1997). The law determines the rights and duties of the both parties. The law "On Doctoral Practise" (effective from May 1997) regulates the installation of primary care doctors.

The number of primary care doctors (interns, family doctors and paediatrists) has not undergone significant change over recent years. During the years 1998 – 2000 it has been 24% of the total number of physicians. Thus the primary health care system is consolidating. In 1999 the ratio of family doctors against the total number of primary care doctors was 42%; at the end of 2000 it had already reached 49%.

Table 5.1: Absolute number of doctors and per 10 000 residents.

	1995	1996	1997	1998	1999	2000
Absolute number of doctors	8326	8541	8313	7964	8041	8134
Per 10 000 residents	33.3	34.4	33.8	32.4	33.1	33.6

The health care policy aims at the promotion and development of primary care. Advantages of this type of care are accessibility of the service, decrease in price of the service and adequate and effective use of medical resources. Primary care doctors not only perform medical treatment but also preventive activities (activities that aim at prevention of acute diseases or aggravation of chronic diseases). The recipient of health care has a possibility to choose

a doctor freely by registering by the chosen doctor in the respective sickness fund.

When necessary, the primary care doctor refers a patient to a consultation with a specialist or to a hospital for further treatment.

Primary health care includes a whole range of inter-related functions and services. Pharmaceutical service ensures the provision of medicinal products required for prevention and treatment against prescriptions written out by physicians or, in some cases, without prescriptions. Pharmacists advise patients on the use of medicinal products as well as on health improvement activities that do not require special treatment. Pharmacists play an important part in informing patients about the need to visit doctors.

Secondary health care activities are directed towards concrete, specialised health care activities that are provided by medical personnel in respective institutions. Secondary health care is specialised out-patient and/or in-patient health care aimed at urgent, speedy and quality diagnosis, intensive treatment and rehabilitation to achieve the patient's recovery or to reduce the manifestations of the disease to a degree that further treatment is possible at the primary health care level. The main competence of the secondary health care is institutional treatment of internal diseases, surgery, pediatry, ortophedy, urology and dermatology.

Medical assistance at hospital can be received in state, municipal and private health care institutions. A patient is directed to these health care institutions by a primary health care doctor or by doctors of urgent assistance teams. In case there are no medical indications for a patient's placement in hospital but the patient wishes nevertheless to undergo health treatment in a hospital, the costs for such a treatment are covered by the patient.

Tertiary health care is characterised by highly specialised medical services that are provided by specialists of one of the medical specialisations with additional qualifications in specialised health care centres or institutions. Usually this type of health care is financed by the state but in case an individual expresses a will to undergo treatment him-/herself, the payments are due by the patient.

Highly specialised medical services are provided by State centers that are financed within the frame of state programmes and are covered by the state budget resources in accordance with regulations of the budget law for a particular year. Quantitative and qualitative indicators of the state health programmes, sub-programmes and activities are determined by the Cabinet of Ministers. The state centres are supplied with highly specialised technologies that are to remain state monopoly.

The professional quality of health care at medical institutions, irrespective of their forms of ownership and subordination, is controlled and monitored by the Quality Control Inspectorate on Medical Care and the Health and Working Capacity Medical Experts Commission which operates as prescribed by the Regulations of the Cabinet of Ministers. All these institutions are subordinated to the Ministry of Welfare.

The state provides opportunities for medical workers to improve their qualifications at the Latvian Medical Academy, the Post- Diploma Training Institute at the University of Latvia and at courses and workshops organised by professional associations of doctors. The existing system of certification and certification renewal for medical workers requires not only the improvement of qualifications, but is an absolute necessity for anybody working in the health care. To ensure the validity of the certificate in a longer period of time, it is necessary to accumulate the so-called "credit points" for upgrading courses and meetings of professional societies attended, for example. The Centre for Medical Professional Education deals with issues related to the upgrading of the qualifications of nurses.

The law "On Medical Treatment", as amended on 1 June 2000, prescribes that only those institutions which comply with mandatory requirements established for medical institutions and their structural units are allowed to treat patients. The compliance assessment at medical institutions and their structural units that have been established by 30 June 2000 had been performed by 31 December 2001.

A major shift toward decentralisation has taken place since 1993. This has taken the form of devolution of powers to local governments. Following enactment of a Law on Local Governments in 1993, most of the responsibilities for provision of primary and secondary health care services were shifted to local governments. Specialised services remained the responsibility of the state. The decentralisation process significantly expanded the roles of local governments in both financing and provision of health care services. However a re-centralisation of financing which took place in 1997 limited the role of local governments to provision only.

On the financing side, territorial sickness funds (for that time called local account funds) were established in each district and large city (i.e. the district level) in 1993.. Funds for health care from the central level began to be administered by the districts and cities through the corresponding local account funds. One of the most important subsequent developments in the reform process, which began at the start of 1997, involved the re-centralisation of financial resources. The compulsory health insurance revenue base was defined to be an earmarked portion of centrally collected income tax plus a state subsidy financed by general tax revenues. In 1997/1998, the 32 local account funds merged into eight regional sickness funds (i.e. formed eight new enterprises) which took on the responsibility of

distributing the state funds for health care. Thus the districts lost their financing role.

At the moment, out of the eight regional sickness funds, six are juridical persons with certain autonomy founded by local governments, while the remaining two are branches of the State Compulsory Health Insurance Agency (SCHIA). Since 1997, SCHIA has been receiving the whole amount of the resources allocated for health care and distributing it among territorial sickness funds in accordance with agreements and established criteria (the normative per one inhabitant etc.) The main tasks of the financial decentralisation were to provide stable and equal funding per capita on territories of all local governments, to ensure a certain base level of health care for all inhabitants, and to create competition among providers of services.

SCHIA provides data for resource allocation to regional sickness funds, and ensures connections between sickness funds' databases and registers of health care personnel, the population and taxpayers. SCHIA also carries out the supervision of health services quality control.

In addition, SCHIA is responsible for directly financing tertiary care and special state programmes in health care.

Recently, the system has experienced some conflicts between SCHIA and the autonomous regional funds, most notably the Riga Regional Sickness Fund covering the capital city Riga, regarding distribution of financing and the procedure of reimbursement. The conflict reached its peak when the Agency refused to extend the contract with the heavily indebted Riga Regional Sickness Fund for 2002, accusing it of financial mismanagement. As a result, a decision has been taken to dissolve the Fund and replace it with a branch of SCHIA.

On the side of provision, local governments have maintained their role in accordance with the Law on Local Governments of 1993. Ownership of most primary and secondary health care facilities (with the exception of highly specialised institutions such as specialized hospitals in oncology, narcology, tuberculosis, psychoneurology, orthopaedics, maternity homes) has been transferred to the municipal level. Municipalities are responsible for assuring access to health care institutions as well as providing outpatient facilities, maintaining municipal hospitals, contributing to the improvement of primary health care and promoting healthy lifestyles and ensuring public safety.. District level responsibilities include ensuring the respective populations with access to health care institutions, provision of health care services, and establishing and maintaining medical institutions, old-age care institutions, asylums for the homeless, as well as health and educational institutions and homes for orphan children.

The authors of the research paper "Health Care Systems in Transition – Latvia, 2001" (European Observatory on Health Care Systems) point out that "there appears to be some ambiguity in the 1993 legislation regarding a specific delineation of the respective responsibilities of districts and municipalities with respect to health care provision."

The role of local governments is seen as central to the development of primary health care, a cornerstone of the Latvian health care reform. Effective co-operation of municipalities with the network of primary care physicians and development of local infrastructure is expanded to contribute significantly to the development of primary care and to the quality and accessibility of services to the entire population. Local governments are expected to determine the geographical location of health care institutions and doctors, to provide population with local transport, etc.

The private sector in Latvia includes institutions that have been privatised, namely many polyclinics and almost all dental practises and pharmacies, as well as some independent primary care practises which emerged following efforts in recent years to develop this form of institutional setting for primary health care. Private providers are contracted by sickness funds to provide services which are specified in the Basic Care Programme. In addition, they may offer services on a private basis.

The full range of primary health care services is available through private provision (i.e. through private, out-of-pocket payments). Services provided mainly in the private sector include certain advanced diagnostic services, sanatoria treatment and psychotherapy. Almost all dental services *for adults* and pharmacies (93%) have been privatised. A much smaller proportion of hospitals is privately owned.

The number of physician joint practices and solo practices constituted 15.6% of all outpatient care institutions in 1999. The other outpatient institutions :polyclinics, outpatient departments and wards in hospitals, treatment centres and maternity homes. Polyclinics are either in the status of limited liability enterprises of municipalities or private. The private dentistry practises compose 67.3% of all dentistry institutions, which are mostly either solo or group practices. The total number of private hospitals increased from seven in 1998 to ten in 1999, constituting 6.6% of the total number of hospitals against 4.6% in 1998.

The share of the number of beds in private hospitals has increased from 1.7% in 1998 to 2.4% in 1999.

However, privatisation of physician practises has not proceeded as rapidly as was hoped, mainly due to financial constraints (low physicians income, high interest rates on bank loans), the uncertainties associated with establishing a practise, as well as administrative barriers and incomplete legislation. Some projects (for example, in collaboration with EU/PHARE)

have attempted to pilot and further the establishment of independent physician practices.

The private systems offer high quality and freedom of choice for the patient but is financially out of reach for much of population.

Since 1995, some sickness funds (especially the Riga Regional Sickness Fund) began to offer voluntary health insurance. However, it is now no longer permitted for public sickness funds to offer private insurance coverage, so as to avoid the risk of excessive private insurance liabilities being met by the public sector (something which actually occurred in the case of the Riga Regional Sickness Fund).

Private insurance companies provide private, voluntary health insurance schemes. These cover patient payments for outpatient and inpatient care; some insurance policies cover dentistry, medication and sanatoria treatment, rehabilitation and drug expenditures. Buyers of private insurance policies are often companies buying group policies for their employees, who thereby bypass problems of access and quality of care found in publicly funded provision. Some private insurance companies contract private health care institutions with advanced technical equipment and standards, which do not have contracts with sickness funds and which are believed to provide better quality of care. They are attractive because they provide access to the most advantaged health care facilities with a higher standard of accommodation and more highly qualified specialists. Private insurance schemes are yet fairly limited, however they are visibly growing. While providing greater choice for patients, this development contributes to the risk of developing a two-tier system of health care provision in terms of access and quality of care. Moreover, there are indications that the private insurers may for the moment be exploiting the confusion in people's minds over compulsory insurance, co-payments, the guaranteed basket of services, etc. to their own advantage as they seek to increase their income (*see Health Care Systems in Transition - Latvia, 2001, European Observatory on Health Care Systems*).

Informal (under-the-table) payments

Surveys carried out in 1999 (Corruption Perceptions Index, Transparency International Annual Report 2000 – please include the source in the references) provides some indications of the current magnitude and extensiveness of informal payments. Of the total number of respondents in the study, 69.5% stated that they never had to make an unofficial payment or gift to state or local health care institutions. By contrast, 24.8% of respondents said they sometimes made a payment or gift, while 5.7% claimed that an unofficial payment or gift was made on almost every visit. The average unofficial payment made per visit amounted to LVL 29. A regional breakdown of respondents indicates that Riga has the highest

proportion of persons who make unofficial payments, amounting to 46.1% of total Riga respondents.

There is a large group of persons (particularly in the rural areas, elderly and other vulnerable groups of the population) for whom this amount would be impossible to pay.

According to survey performed by the Soros foundation, the under-the-table payments to doctors results in 9 mln. LVL per year (6% of all health care expenditures).

The NGO Centre for Patients' Protection states that the maximum amount of unofficial payment on which the Centre has been informed, was 4 thousand US\$ for a surgery operation.

Public health system

The Ministry of Welfare formulates and implements policies and strategies in several areas of public health: health promotion, epidemiological safety and environmental health.

In Latvia the scope of the notion 'public health' has not yet become completely stabilised. Public health encompasses almost all areas of human activity and therefore it does not easily yield to definition.

In the year 2000, a document entitled "Public Health Strategy" was formulated and approved by the Cabinet of Ministers. It describes the public health situation in Latvia, compares it with other European countries, discusses the main problems, identifies objectives and recommends ways for their achievement.

The co-operation between sub-sectors in the area of public health is becoming more active. In year 2000 a co-ordination commission, promoting co-operation between sectors, started its work in public health. It includes representatives from various ministries, the Association of Municipalities, non-governmental organisations and mass media. It is a very important undertaking, as the improvement of the public health area requires contributions from many sectors.

Health promotion or, to be more precise, the promotion of a healthy life style is one of the instruments which are used for information and education of the community on issues of a healthy lifestyle. The level of public health is largely dependent on the care of inhabitants themselves about their health. The better the community understands the significance of prevention and a healthy lifestyle in retaining one's health, the less resources will be required for the treatment of neglected diseases.

In order to identify what negative habits affected the health of inhabitants of Latvia, in 1998 Latvia started to participate in the FINBALT health monitoring project. In the Baltic states surveys are conducted every second year and thus in 2000 the second survey has taken place in Latvia. The study analyses how health is affected by smoking, nutrition, the use of alcohol, physical activities, the hygiene of the mouth cavity, traffic safety, behavioural trends, participation in the health promotion and other factors. Results are to be used in formulating and evaluating health policy in Latvia, and they provide data for the public health services as well.

Taking into account the fact that for a long time the main cause of mortality in Latvia is cardiac and cardio-vascular diseases, the year 2000 was declared the Year of Healthy Heart.

The fact that the desire of the population to change habits is growing can be viewed as a result of the Year of Healthy Heart. However, on the whole, it will be possible to evaluate the efficiency of activities only after a longer period of time during the assessment of changes in morbidity rates. A future priority is the promotion of the use of addictive substances. Over the last decade the number of users has been growing rapidly.

The area of epidemiological safety in Latvia is regulated by the Law "On Epidemiological Safety" (30 December 1997). In 2000, the Cabinet of Ministers approved hygiene requirements for hairdressers' shops, swimming pools, service hotels, social care institutions and public baths on the basis of this law. Compliance with requirements is controlled by the State Sanitary Inspectorate.

The situation in the area of epidemiological safety must be viewed as serious because, in 2000, there was a wide evidence of diphtheria and epidemic parotitis and there was a rapid increase in the incidence of HIV and AIDS.

Environment has a significant influence on health. Thus supervision over environmental risk factors is one of the prerequisites of public health. Over the last years one of the public health priorities was the safety of food: the circulation of food for processing, manufacture, packaging, storage, reloading, transportation, imports, exports, distribution, cooking and other stages of the distribution of food. For Latvia to be able to enter the European market with more success, it must ensure control and supervision over food distribution, complying with the requirements of the European Union. In 2000, work started on the implementation of the joint project of the Ministry of Welfare and the Ministry of Agriculture "Food Control, Upgrading and Consolidation of Capacity at the National and Regional Level" within the framework of the EU Phare National Programme. Within the framework of the project, the food control institutional system is to be optimised, the legislative base improved and the exchange of information among

controlling institutions improved. Investments in laboratories involved in food control are also expected within the framework of the project.

The National Environmental Health Centre monitors the quality of drinkable water and bathing places.

At present, no systematised information is available in Latvia on several significant environmental health factors: noise level, sources of noise emission and health disorders caused by noise. There is no objective information on the quality of the working environment and its impact on the health of employees.

5.1.2 Benefits

The range of primary and secondary health care provided - the "Basic Care Programme" - is established each year since 1994 by the Regulations of Cabinet of Ministers. This is the basket of medical services, which should be provided for each citizen and legal resident and financed from the Basic State Budget (and to some extent, co-payments). The Basic Care Programme includes emergency care, treatment for acute and chronic diseases, prevention and treatment of sexually transmitted and contagious diseases, maternity care, immunisation programmes and provision of pharmaceuticals free of charge for entitled groups. Dental care is part of the package only for children up to the age of 18 years.

Contrary to earlier provisions, dental care for adults has been excluded from the basic package and is provided by private practitioners at the patient's own *expense*. Surgical treatment of non-life threatening diseases (such as hip replacement), intramuscular and intravenous injections in out-patient institutions, vaccination and rehabilitation treatments for certain conditions are also not included in the Basic Care Programme. In addition, sanatoria treatment, cosmetic surgery and *in vitro* fertilisation are only provided at the patient's own expense.

New services will be included in the health care minimum when the economic situation improves. Until now, the Basic Care Programme shows a tendency to be reduced every year (see Health Care Systems in Transition -Latvia, Observatory, 2001). In the contrary, SCHIA states that the "minimum service basket" has remained the same as previously, only the patients have to wait in queues for surgery (for example, cardiosurgery and placement of endoprosthesis).

Costs of services which are not included in the basic programme must be covered by the patient or private insurance company, if the patient is insured. In the latter case the coverage of costs depends on the kind of insurance policy: the cheapest ones cover the treatment costs only partially.

In addition to the Basic Care Programme, the state finances certain services that since the beginning of the reform were recognised to warrant stable and defined funding. These services are provided through a number of state programmes. For the time being there are following state programmes:

- diabetes;
- diagnosis, treatment and control of alcoholism and drug addiction;
- care of patients with burns;
- a portion of tertiary care requiring specialised centres and equipment (for example, invasive cardiology, cardiac surgery, haemodialysis and kidney transplantation);
- programme of hygiene and epidemic control;
- ministerial control, supervision and statistics.

Assessing the health care systems of 191 countries, the World Health Organisation placed Latvia 105th in the world (World Health Report 2000). This assessment is based on the analysis of the system's capacity to enforce such principles as equality, fairness in allocation of financial resources and ability to meet the needs of the population. The population's state of health in relation to the standard of living is also taken into account.

5.1.3 Financing of the health care system

Latvia's total expenditures on health in year 2000 represented only 3.5% of its GDP, which is insufficient for the improvement and development of medical services. From 1995 State expenditure on health are showing a downward trend (see also Table 3 and 4 in annex to Chapter 1). At the same time, the privately financed (out-of-pocket) portion of health care has been steadily increasing.

Although the proportion of expenditures on health has slightly increased in 2002, its actual volume is very small and does not resolve pressing problems related to the financing of this sector.

There is no law that would regulate the order of health care financing. For the time being, these issues are regulated by the Regulations of the Cabinet of Ministers of 12 January 1999 "Regulations of Health Care Financing".

Financing from the State Basic Budget

Health care services are financed partly by the state and partly by the patients. State resources are allocated according to the number of registered residents throughout the respective sickness fund. State resources (from the Basic State Budget) for financing health care are earmarked: 28.4% of personal income tax revenues are allocated for financing health care expenditures is covered by this?) and distributed according to the number of

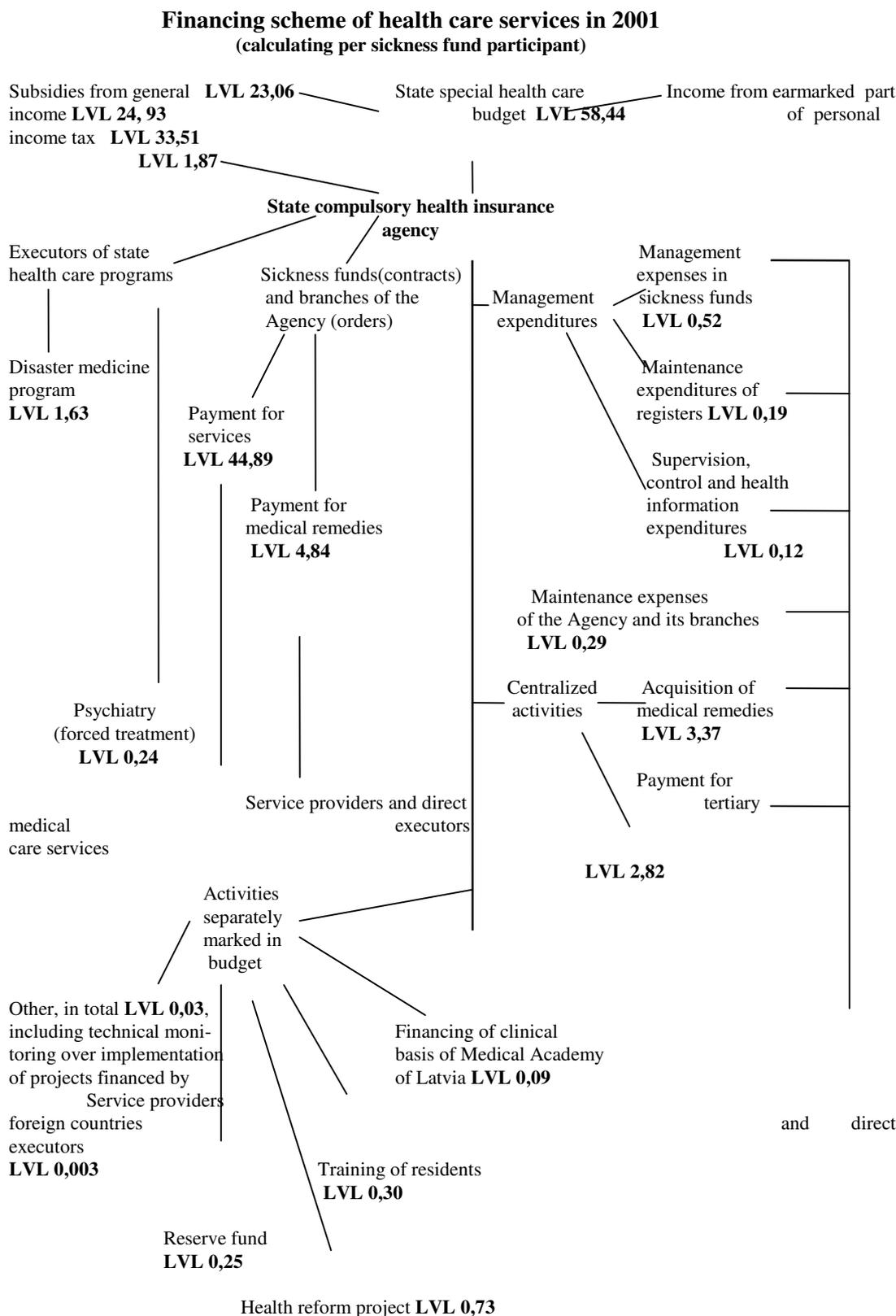
registered participants of the respective sickness fund. The system is also subsidised by grants from Basic State Budget. The state programmes in health care are financed from the Basic State Budget. The amount of state budget subsidies over the last years has been stable (55.9 mln LVL in 1999; 54.1 mln LVL in 2000 and 54.6 in 2001).

Table 5.2: State Compulsory Health Insurance Resources in 2001 (in LVL)

Available funding - total	142 239 295
Income in total, of which	137 312 823
Subsidy from state basic budget	54 613 594
Income from personal income tax	79 770 952
Payment services	2 928 280
Loan from the state basic budget	3 163 303

Source: Sickness Fund News Nr. 10, 2001.

Figure 5.1: The distribution of sources per one patient.



Source: Sickness Fund News Nr. 10, 2001.

Patients' payments constituted a total of 8 303 609 LVL. This share of revenues is not included in the State Compulsory Health Insurance Resources and is considered income of the respective medical institution.

All those funds are managed by the State Compulsory Health Insurance Agency. SCHIA is a non-profit state joint stock company whose founder and owner of capital is state. The Ministry of Welfare is holder of the state capital in the Agency. SCHIA is managed by Board, members of which are appointed by the Minister of Welfare. The director of SCHIA is the executive of Board decisions. The funds of Basic Care Programme are distributed to the eight regional sickness funds. These in turn purchase services from providers on a contractual basis. From the funds of state programmes, the Agency directly pays providers for their services. A third portion of funds is allocated to centralised purchasing, which includes expenditures on pharmaceuticals included in the positive list, and other supplies and equipment.

The legislation does not contain any provisions for the case of deficit in the State Health Care Budget. If a regional sickness fund has insufficient resources by the end of the year, it minimises the benefits.

Capital investments are financed by the Ministry of Welfare through the State Investment Programme and supervised by the Ministry of Economics and Ministry of Finance. Capital investments cover only the public sector and there is no special system to ensure an equitable regional distribution.

Reimbursement system for medicinal products

As described before, part of State Basic Budget revenues are allocated for reimbursement of patients' expenditures for some medicinal products.

Reorganisation of the previous reimbursement system and establishment of a new system for reimbursement of purchased medicinal products is supposed to stimulate economy of resources and the increase of cost-effectiveness in health care. The new system complies with EU requirements.

The new regulations, effective from 1 January 1999, enable the patient to purchase medicinal products, medical appliances and goods as well as expenditures related to the purchase being paid by sickness fund, taking into account the patient's diagnosis but not the patient's belonging to the special social group (previously preferential treatment was granted to such categories as disabled of the 1st category and politically persecuted persons). Expenditures incurred in the purchase of medicinal products, medical appliances and goods are reimbursed to a specific patient with a clearly stated diagnosis, taking into account the nature and the severity of the disease, if no other substitute and less costly type of treatment is available in the given case.

The list of reimbursable medicinal products is established and actualised by the State Agency on Prices of Medicinal Products. It determines criteria for the inclusion of a medicinal product in the list of reimbursable medicinal products and the calculation of the amount of reimbursement at pharmacies. Medicinal products are included in the list, taking into account their effectiveness, safety and treatment costs.

In accordance with the official opinion, this system is a compulsory health insurance organised by state (*see Chapter 2.2.2*).

The funding of health care system includes sources of local governments too. The latter are voluntary, because local authorities themselves may increase planned expenditures on health care above the amount foreseen by the national health care budget.

External sources of funding

Latvia has obtained loans from the World Bank and PHARE programmes for health care system. Assistance from different international organisations (UNDP, Red Cross etc.) is mainly directed for special programmes for staff education and service expansion.

The World Bank provided a credit for the Latvian health care reform. The main aim of this project is improvement of the Latvian health care system's quality, efficiency and accessibility. The project is supported by a US \$ 2 million grant from the Swedish International Development Agency and US \$3.6 million from the Government of Latvia. The project is to be implemented in two stages. The first stage took place in the period between 1999 and 2001. The second stage is planned for the period 2002 -2005. The loan for the first stage is US \$ 12.0 million, and for the second - US \$ 20.0 million. Contrary to the widespread disapproval of the health care system by the general public and even domestic policy-makers, the World Bank has recently deemed the progress of the reform as 'successful'.

The project includes support for health care system administration, reform of health care financing, strengthening of sickness funds, management of the health information system. For inpatient institutions, there is a financing model based on diagnosis-related groups (DRGs) and remuneration in the primary health care system is to be based on the capitation model. The State Compulsory Health Insurance Agency will establish a public information system, financial audit system and staff training programme.

Out-of-pocket payments (private sources)

The patients are performing payments from their private sources for the medical treatment. The totality of payments made by a patient during one year is limited to a maximum of 80 LVL (excluding payments for drugs,

spectacles and dental services). Any amount spent above this is reimbursed by the regional sickness fund. Defined vulnerable groups are exempt from payment of patient payments. There are 16 such groups, including children under 1 year of age, handicapped children up to age of 16 years, pregnant women receiving pregnancy care, tuberculosis patients and others. Urgent medical care is free of charge.

Patient fees were the first element of patient participation in the financing of health care to be introduced in the early 1990s. The amounts were at first symbolic, however private (out-of-pocket) expenditures are increasingly making up for the shortfall in public spending.

Fiscal crisis of 1995 precipitated a sharp decline in health care financing. To deal with this, Regulations of the Cabinet of Ministers were passed, allowing patients to be charged for up to 25% of the cost of care under the Basic Care Programme. This 25% co-payment posed enormous problems for patients and providers alike. Patients were unable to understand the method of calculation of co-payment and also, in many cases, were not able to perform this payment. Hospitals, on the other hand, were unable to collect it fully. According to the State Sickness Fund (now – SCHIA), in late 1995 and early 1996 the actual amount of co-payments was no more than 12 -13% of costs, and much less in areas with high unemployment. Health care facilities ran into financial difficulties because, while they spent all necessary funds for services provided, they were reimbursed for only 75% of their costs.

In 1997, the percentage of the Basic Care Programme costs that were to be covered by out-of pocket payments was reduced to 20%, consisting of 15% co-payment and 5% patient's fee (In 1997, the patient's fee was defined as a patient's private payment for treatment in the outpatient institution; co-payment - for charges in a hospital, both for services provided within the minimum care program. The next Regulations (1999) defined only patient's payment (or more precisely - patient's contribution) for both cases. In practice and in the special literature both previously defined terms are used, but without consistency.)

Regulations of the Cabinet of Ministers issued in January 1999 determine the amount of patient's payments for services provided within the minimum care programme. These are as follows:

Outpatient care: in the outpatient clinics patients payment is 0.50 LVL for adults and LVL 0.20 for children per day. The payment for a physician's home visit is LVL 2.00.

Inpatient care: the entering charges in a hospital are LVL 5.00; a day cost of LVL 1.50 for adults and LVL 0.45 for children - from the second day of treatment. For manipulations, charges are defined separately. The day costs for adult services included in a state programme is LVL 0.45 per day. The

patient's payment per period of hospitalisation may not exceed LVL 15.00 for adults and LVL 5.00 for children (excluding payments for manipulations).

Case studies.

1. Simple case.

The patient with diagnosed pneumonia has been treated in the hospital for 6 days. There are no complications requiring expensive manipulations. The patient's payment will be the following:

$$\text{LVL } 5 \text{ (entering charge)} + \text{LVL } 7.5 \text{ (} 1.5 \times 5 \text{ - cost for 5 days)} = \text{LVL } 12.50$$

2. Case involving surgical treatment.

The patient needs a surgical blood-vessel operation. He has been treated in the hospital for 10 days. The price for the patient for the most complicated case of blood-vessel operation is LVL 50.80.

The patient's payment will be the following:

$$\text{LVL } 5 \text{ (entering charge)} + \text{LVL } 13.5 \text{ (} 1.5 \times 9 \text{)} + \text{LVL } 50.80 = \text{LVL } 69.30$$

In secondary health care (institutional care) minimum level of services is guaranteed by the state and basically financed by sickness funds. For staying in a health care institution patient performs a payment that does not exceed 15% of the costs of the medical services provided. In case a patient wants a separate room with comfort, the amount of payment for services is determined higher.

Management of financing by State Compulsory Health Insurance Agency

Since 1998, regional sickness funds pay for inpatient care according to:

1) Diagnosis: 64 diagnosis-related groups (DRGs) have been specified where the patient's treatment costs are calculated according to the ICD -10 classification. These groups have fixed payments, treatment intervals and performed manipulations (such as laboratory tests; blood-count; x-ray examinations; ultra-sonography; computer tomography; various surgical procedures - cavity punctures, bone immobilizations; surgical operations). It is hoped that this will ensure service quality and protect the patient.

2) Bed-day payment (for hospital treatment) : the bed-day price is calculated according to number of staff, social insurance contributions payments and maintenance expenses.

The average bed-day price in a public hospital is 10 LVL.

3) Points: hospitals receive additional reimbursement for manipulations that exceed 1100 points according to the Criteria for Health Care Services and the point price. The criteria are worked out by the State Compulsory Health Insurance Agency together with professional associations of physicians. The Agency fixes the points price. Points cover the salaries of medical staff and expenditures on medical materials.

The health care facility is contracted to provide a certain number (quota) of interventions for a certain price. If the facility undertakes more interventions, it does not receive additional funding. Similarly it does not receive more funding if the service provided by the health care facility costs more than the price stated by the Agency.

Hospitals may charge for certain services. For example, the patient has to pay for extra comfort - a single room, individual nurse, special menu, refrigerator, television and extra consultations that are not considered necessary for the treatment and are not covered by the sickness fund. This allows for an increase in the hospital's revenues. As the hospitals are in the status of enterprises they can freely decide about the use of such means. Salaries of hospital staff may be increased from these revenues.

Before receiving planned hospital care, patients sign an agreement with the hospital administration. The costs are calculated prospectively. The remaining expenses following patient's payments are covered by the regional sickness fund. In practise, the income of the population is rather low and there are no mechanisms for making people pay. As a result, hospitals manage to collect only a fraction of planned payments from patients, especially in rural areas.

Patients payments in 1999 amounted to 7% of hospitals' total income (estimate of the Ministry of Welfare).

There are no precise statistics available about the structure of financial resources, and there are wide disparities among different sources of information. According to the WHO Regional Office for Europe database, about 79% of resources for health care are financed through taxation revenues, and remaining 21% from out-of-pocket payments. WHO's World Health Report 2000 estimates out-of-pocket payments to be 39% of total. By contrast, the Ministry of Welfare estimates these to be only 7-10% of the total sum.

Private insurance represents a very small but increasing amount (Health Care Systems in Transition -Latvia, European Observatory on Health Care Systems, 2001) .

The estimates of the Ministry of Welfare are based on statistics on real total revenues recieved from the patients.

WHO estimates may be based additionally on case studies, option pooling, taking into consideration informal payments, as well as including private providers into the scope of the study. But it is only the author's speculation.

Remuneration of doctors

Until 1993 the salaries of physicians in medical institutions were fixed. Extra payment was paid for night work and unhealthy work.

In the year 1997, the remuneration system in the out-patient sector was changed. The newly established regional sickness funds, financed from the Basic State Budget revenues distributed through the Central Fund, began to contract out-patient care providers. In the case of out-patient care, the new payment system introduced in most of the regions of the country (covering about 75% of the population) was the points system.

According to the points system, each item of service was assigned a number of points according to a scale of service intensity. Physicians working in outpatient institutions had to fill out an account form for manipulations (there is no maximum amount of points set for doctors). Each service was assigned a number of points. Sickness funds paid the outpatient institution according to the number of points corresponding to the services delivered.

Physicians working in inpatient institutions and outpatient sections of hospitals and polyclinics (i.e. specialist physicians) are paid partly on the basis of the fixed salary, which is denoted in their contract with the facility where they work. In addition, these doctors receive extra payments for manipulations that exceed 1100 points. Based on the formula, the points are converted into currency. The salary is usually 40 - 50% of the total points value. The salary cannot be lower than the minimum wage set for the country as a whole. Private practitioners who are contracted are paid on the basis of points, or out-of-pocket payments made by the patient.

It is now broadly acknowledged in Latvia that the points system was a mistaken policy, as it encouraged a larger necessity volume of services and costly interventions as opposed to simpler but equally effective ones, and promoted curative care at the expense of preventive or health promotive care (see *Health Care Systems in Transition - Latvia, European Observatory on Health Care Systems, 2001*).

In 2000, an updated version of the organisation of primary health care and the procedure for payment was approved. According to the mixed capitation model, the primary health care doctor receives part of funding depending on the number of registered patients and their age structure and part in the form of fixed additional payments. A portion of this payment constitutes general practitioner's remuneration and a portion is a fixed payment for remuneration of the primary health care nurse. In addition, the general

practitioner pays for services of specialists to whom patients have been referred.

In 2001 the procedure was changed again, regulating the mutual co-operation of health care service providers and the procedure for calculation of the capitation money by the sickness fund in accordance with the agreement concluded with the State Compulsory Health Insurance Agency. It also defined "expensive examinations" which were not financed from the funds of the primary health care doctor and also established the price list for versions of care and the amount of the fixed additional payments for the primary health care doctor. Services of doctors – specialists - are paid in accordance with referrals by primary health care doctor. An exception is consultants, of fixed payment, or doctors - specialists, whose remuneration comes from special earmarked funds and who provide health care services without referrals from the primary health care doctor within the minimum amount of health care services to patients with a diagnosed disease in the respective specialities: phthysiopneumonologists (tuberculosis), psychiatrists, narcologists, dermatovenerologists (sexually transmitted diseases), endocrinologists (diabetes) and dentists (dentists' services to children and military conscripts).

Doctors and other medical workers at hospitals are receiving a salary, the amount of which is determined by the administration of hospitals, as they have the status of enterprises.

According to SCHIA, the remuneration system is developing into a model where the cornerstone will be the price of services provided. The price is calculated taking into account the salaries of medical personnel, social insurance contributions, the price of medicinal products and other patient's maintenance costs and expenditures for development (investment in high technologies, training of staff etc.).

Table 5.3: Payment mechanisms (remuneration of doctors)

Family doctors (general practitioners)	Part of capitation payment
Specialists	Family doctor pays according to price of services provided
Specialists (treat without referral from family doctor)	From special resources according to price of services
Physicians in hospitals	Fixed salary + points price
Dentists (if contracted by Sickness fund)	According to price of services provided
Pharmaceuticals (if contracted by Sickness fund)	According to price of services provided

5.1.4 Incentives

As noted before, the cornerstone of the reformed system is supposed to be the primary health care. Over recent years, the number of primary care doctors (interns, family doctors and pediatricists) has stabilised, testifying to the consolidation of the primary health care system.

The reform aims to establish the optimal number of hospitals and beds using both economic and medical criteria and to reduce the length of a patient's hospital stay, which was excessively long in the past.

Although the number of hospital beds and doctors has fallen, the Health Department of the Ministry of Welfare still believes there are too many doctors. The demand for doctors, especially in out patient clinics and hospitals, is in decline, suggesting that many health care professionals will be forced to undergo retraining.

In 2000 the population could receive health care services at 142 hospitals, 1659 out-patient clinics and 322 paramedic-midwife and paramedic units.

Table 5.4: Number of family doctors

	1995	1996	1997	1998	1999	2000
Number of family doctors	141	302	391	488	801	966
per 10 000 inhabitants	0.6	1.2	1.6	2.0	3.3	4.0

Source: Data of the Department of Health Statistics at the Agency of Health Statistics and Medical Technologies.

Thus one can conclude that the structure and size of the medical personnel is sufficient to provide health care services.

On the other hand, the low funding of health care, taking into account inflation, the depreciation of technologies and other factors, not only does not ensure the development and improvement of health care services but, to some extent, does not allow provision of health care services at the current level of quality.

The quality of the services provided is heavily influenced by the low level of salaries of the medical personnel as well.

Many nurses have expressed readiness to leave Latvia and work at medical facilities in other countries, due to their low pay and perceived lack of respect for their profession.

5.1.5 Coverage of the system

All Latvian citizens and permanent residents of Latvia are entitled to state-funded health care. Thus, in theory, the coverage of the statutory system is universal.

In practise, many people are excluded from the system due to lack of sufficient means. The Social Report 2000 by the Ministry of Welfare states that 48% of those polled do not visit a doctor even when ill because they lack the means for treatment. One third of those polled can find the means with great difficulty in the case of serious illness, and less than one fifth (19%) can afford treatment without worrying about having enough money left over for other needs.

Findings of this research give rise to critical evaluation of the accessibility of medical services. 51.6% of those polled buy medication prescribed by doctor irregularly, 75% explain such actions by lack of money. 29.3% have expressed dissatisfaction with the medical help provided at their place of residence, 23.3% - with the queues waiting for the doctor, 14.4% find the distance to the medical institutions too long (in 29% cases the place where people can receive medical help is more than 5 km away from their place of residence). The latter case is characteristic for rural areas, where there are serious problems related to the public transport. (This study was carried out by the Agency on Health Statistics and Medical Technologies and their results presented in Social Report 2000).

One of the goals when implementing the new primary health care structure (family doctors) was to place doctors' practices as close to recipients of services as possible. An essential part in the process was played by co-operation with local governments, as accessibility of health care services depended not only on good specialists in certain areas but also on the condition of the local infrastructure. The role of local governments is most profound in determining the geographical location of medical institutions and doctors' practises, the improvement of roads, the provision of public transport.

As the results of the above-mentioned surveys show, the goal, formulated for the reform in this area is not yet achieved. The health care facilities are distributed among the regions of the country proportionally to the number of residents, but are not always easily accessible.

So far only about 80% of residents have registered with family doctors.

The access to care is equal for men and women. Nevertheless, one has to bear in mind that women are more affected by poverty (*see also Chapter 1 and 4*). That lets us conclude that the reasons for not visiting doctors and undergoing medical treatment described above are more widespread among women than among men.

The choice of treatment and its provider is fully free, thus there are vast possibilities to opt out of the statutory system, if having sufficient means for treatment by private doctors and institutions.

It is not mandatory to register with a family doctor, but for persons who have not chosen such a doctor, the patient's payments are substantially higher when entering the primary health care institution. For example, the patient's payment for a physician's home visit is LVL 2. If the person does not have a family doctor - the patients payment for home visit is LVL 5.

5.1.6 Public acceptance of the system

The public opinion pooling conducted in 1998 on health care accessibility and health care insurance revealed the main areas of patient dissatisfaction with the health care system: lack of money for out-of-pocket payments, uncertainty about health care costs and physicians' professional skills and experience, shortage of specialists, long queues and problems with transport and long distances to the health care services. 29.3% of respondents were not satisfied with the health care system (*see Health Care Systems in Transition -Latvia, European Observatory on Health Care Systems, 2001*).

The dissatisfaction has only grown during the following years. Often patients do not understand which services are free on charge and which have to be paid for. The people are claiming the system to be intransparent and in chaotic state.

The head of Patients' Interests Protection Centre stated in an interview that she is not able either to advise the people and explain how much the medical treatment will cost on particular occasions.

Recently health care has become the most widely discussed and problematic area of the welfare sector. The progress of the reform is resisted not only by the population but also by the medical staff.

In the State Basic Budget for 2002, 20 mln LVL were earmarked for raising the wages of medical workers, but until now this decision has not been realised. Thus the Trade Unions of Medical Workers are planning a strike for the end of May.

Under the pressure of public opinion, Prime Minister in May 2002 asked the Minister of Welfare to resign, motivating the resignation with unsatisfactory situation in the health care sector. Adviser to the previous Minister, responsible for implementation of health care reform, was nominated as the new candidate for the Minister's post. Giving interviews, the candidate, who is a member of the same right-wing political party as the previous Minister, declared that there are no problems in the health care system and the reform process is developing successfully.

Despite discrepancy between evaluations made by the Prime Minister and declarations made by the candidate for the Ministers' post, the candidature was supported by Cabinet of Ministers and the new Minister was appointed by the Saeima (Parliament) on 22 May 2002.

5.2 Evaluation of future challenges

5.2.1 Main challenges

Demographic indicators of Latvia are among the lowest in Europe (*see chapter 1*). Throughout the last decade, natural growth has been negative. Changes in the age structure of people in the last two Population Censuses testify to the general aging tendency of population. According to the Population Census 2000, 18.1% of all residents were children under 14 years of age, compared to 21.4% in 1989. At the same time, the share of 60+ year olds had reached 21%, compared to 17.4% in the Population Census 1989.

Public health plays an important role in the demographic processes. Changes in public health can be best measured by mortality and life expectancy indicators, as well as through data on the public's own evaluation of its health. Central Statistical Bureau studies show that every fifth resident of Latvia evaluates his or her state of health as poor or very poor.

To achieve positive changes in the demographic processes, the Ministry of Welfare has developed an action program for improvement of the demographic situation. The main goal of the program is to secure a qualitative and quantitative reproduction of people. Strategic directions in implementation are strengthening of families and promotion of birth rate, raising educational and cultural levels. Feasibility of the objective is linked with the economic growth of the country, increase of employment, perfection and further growth of the system of science and education. The Public Health Strategy aims to improve the public awareness of health as a value.

Results of the survey for year 2000 show that in comparison to the previous years the desire of inhabitants to change their negative habits has grown.

5.2.2 Financial sustainability

Although the health care reform is aimed at developing a balanced and financially sound health care system, at the time being the system is experiencing severe difficulties.

At the moment it is not easy to speak about the financial sustainability of the health care system, as it is recognised to be in crisis situation because of inability to solve the current financing problems.

The fact that funding allocated for health care has been even more reduced in 2000 and 2001 gives rise to particular concern. Due to a shortage of resources, sickness funds are unable to pay medical institutions for services provided. By the end of 2001 some hospitals refused to treat patients, except for cases of emergency. Until now there is no answer who will repay the debts to pharmacies for the medicinal products eligible for reimbursement. Under the legislation in force, those expenses should be covered by sickness funds, however the financial problems experienced by the latter have already resulted in soaring debts.

To a large extent, this deadlock contributed to the resignation of the former Minister of Welfare.

Of course the situation is mainly caused by the shortness of funding. At the same time it should be noted that not all sickness funds experienced such a difficulties as, f.i. the Riga Regional Sickness Fund.

As described above, the regional sickness funds are contracted by the State Compulsory Health Insurance Agency, which supervises the activities of regional sickness funds. In the author's point of view, the administrative capacity of the Agency has to be improved and the financial auditing procedures have to be performed on regular basis.

In the framework of a World Bank project, improvement of the health care system administration is envisaged: strengthening of sickness funds, management of health information system. The rational management of the funds to disposal and the increase of the State Basic Budget revenues allocated to financing of the health care will contribute to the financial sustainability of the system in the future.

When developing this project, the projections will be made with regard to demographic, economic and expected social changes. It is supposed to involve specialists of the Economic Analysis and Forecasts Division of the Social Insurance Department to develop the economic and demographic estimates as to the possible long term costs. If it is going to be the case, the division will be reorganised so as to carry out forecasts and projections for all sectors of welfare.

5.2.3 Health care policy and EU accession

In 2000 the State Compulsory Health Insurance Agency prepared a report containing a calculation of the possible impact of Council Regulation (EEC) No 1408/71 on the Latvian health care system. The calculation was based on

the amount of health care services received by individuals and the movement of persons between Latvia and EU countries in 1999.

According to the calculation, the projected expenses of Latvia for immediate medical care received by its residents in the EU countries amounted to LVL 1 046 000. The expenses of the EU countries amounted only to LVL 67 000. The main reason is the current difference in costs of medical treatment in Latvia and the EU.

The expenses of Latvia for planned medical services in the EU were calculated only approximately and they can amount to LVL 2 000 000 per year.

One of the problems in Latvia is that state-guaranteed minimum of health care services is set at a pretty high level and means for financing are inadequate. The Report concluded that in order to implement Council Regulation (EEC) No 1408/71 Latvia needs to increase the current expenditure for health care by approximately 1.5%.

One of the main potential problems in the field of health care related to the EU accession stems from the fact that the Latvian health care legislation at the moment fails to meet its international obligations. As pointed out in the concept paper "System of Legislative Acts in the Field of Health Protection" by the Ministry of Welfare, "non-compliance of legislative acts with the international human rights norms in the field of health protection will hinder the process of integration".. Although Latvia has joined several international conventions and acknowledged other international legal acts in the field of health protection, the respective provisions have not been transposed into the national legislation as yet. Recent legislative initiatives are aimed at correcting this drawback. For instance, the draft laws "On Health Protection", "On Sexual and Reproductive Health" and others contain provisions transposing requirements of the Council of Europe's Convention on human rights and biomedicine.

As the income of physicians in publicly provided services are among the lowest in the country, many of highly qualified doctors are working abroad. Some countries (for example, Norway and Germany) are recruiting nurses from Latvia. After the accession to EU with the removal of borders, one can expect that migraton process will extend and medical personnel (especially with knowledge of foreign languages) will make use of the new opportunities, offered by the free movement within the EU.

5.3 Evaluation of recent and planned reforms

5.3.1 Recent reforms and their objectives

The goal of the health care reform is to create a patient-oriented, rational and universally accessible health care system in Latvia. The new system would

be based on primary health care and prevention and also on a universal, effective and united system of health protection.

”A comprehensive reform of the health care system is underway in Latvia, its purpose being to improve the health care of the population and to ensure more rational expenditure of the allocated national budget resources. During the reform, the health care system is to be developed further and the structure of services providers is to be optimised. This will achieve their consolidation, improve the quality of health care services provided, promote cost-efficiency and rational accessibility for patients, as well as which a basis should be created for the development of an integrated health care system at the regional and the national levels. Regional and national plans for health care development are formulated for the achievement of the above objectives. The reform is to result in the establishment of a balanced and financially sound health care system, based on primary health care and prevention” (Social Report 2001).

In 2001, the Cabinet of Ministers ordered the Ministry of Welfare to draw up a comprehensive concept paper of the legislative system in the field of health protection. This paper has now been adopted by the Cabinet of Ministers. It specifies the role of every legislative act in regulating the field of health-care, points to the required amendments in existing legislation, as well as legislation still to be developed, i.e. laws on health-care financing, patient’s risk insurance, liability for damage caused by treatment etc.

5.3.2 Political directions of future reforms

Within the ruling coalition there is a strong political consensus about the future direction of health care policy. The three ruling right-wing parties believe that the reform should be continued, developing its legal regulation and explaining the essence of the reform to the general public.

In the wake of the forthcoming general elections (scheduled to take place in October 2002), a new liberal party ”The New Time” has entered the political arena. The opinion polls show that at the moment it is holding a firm lead over the ruling parties. This phenomenon can be explained by the leadership of the charismatic Einars Repse, until recently the head of the Bank of Latvia. In the eyes of the public, his name is strongly associated with the successful Latvian monetary policy - the stable exchange rate of the national currency Lats.

The programme of this party proposes to introduce a genuine health insurance system, as one of the types of state social insurance. In order to avoid raising the overall contribution rate, the programme at the same time plans to transfer unemployment benefits from social insurance to State Budget. It has to be noted that such an approach is often advocated by ILO

experts with the justification that the state should take responsibility for failing to provide residents with employment.

The left-wing opposition parties, as a rule, criticise the existing health care system and in their programmatic documents promise to change it for the good of the people, however eventual instruments for such a reform appear blurred or missing.

5.3.3 Conclusions

Latvia's health care system has undergone significant reforms since the beginning of the 1990s. One of the main accents has been placed on changing the financing of health care. This is a very important issue because the insufficient financing of health care, the inability of the poor to pay for medicines and treatment, and the low standard of living have led to a deterioration in the overall health status not only in Latvia, but also in other European transition countries.

In 1997 a national health system was introduced, along with a list of minimum medical services covered by the State. However, the resources at the disposal of the sickness funds are not sufficient to cover the health care expenses.

Until 2002 state investment in the health care had decreased each year. In 2002 the resources for health care system have increased, however the increase is limited to only 0.1% of GDP.

Hospitals are already turning down patients who have applied for elective surgery or other planned treatments. The modest funds of the state budget are sometimes supplemented at an unofficial level by the patients themselves, resulting in corrupt practices at Latvian medical facilities.

The authors of the Latvia Human Development Report 2000/2001 state: "The difficulties experienced by health insurance funds show that in contrast to the pension system, Latvia's health care system is not yet stable and its sustainability is not guaranteed. At the level of the individual recipient of health care services, no meaningful progress can be observed."

The author can add that not only the pension reform has created a stable system, the implementation of the whole social insurance system has succeeded. The same can be said in respect of the social assistance system. All sectors of the welfare system are claiming insufficient means, but the systems themselves are operational. It seems that the health care reform has so far been least successful.

The country's GDP began to grow rapidly only recently, the unemployment rate continues to be high, and state budget funds for the health care system are limited. Thus, the overall economic condition of the

country is and will continue to have a decisive impact on public health conditions.

But not only lack of financial resources is the reason for unsatisfactory functioning of the health care system. World Bank experts have noted that the most serious problems of the health care system in Latvia are inefficiency of health care services, especially in hospitals and the problem of control and transparency of health care services (*World Bank Strategy in Latvia 2002 - 2005. Draft, October 30, 2001*).

The Ministry of Welfare of Latvia has contributed to potential solution of the current situation by drafting various strategic documents, such as the Public Health Strategy, Health Care Development Plans, the Psychiatric Assistance Strategy for 2000-2003, Concept of Legislative Acts in the Field of Health Protection etc.. A uniform system of environmental health indicators has been developed within the framework of the applied research.

Now it is time to consider how to make the system more transparent and understandable for the population. It is the task of the State Compulsory Health Insurance Agency to improve the co-ordination and control of service providers and exclude such events as the insolvency of the Riga Regional Sickness Fund, which took place by the end of 2001.

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