



## ASSESSMENT REPORT

# ASSESSMENT OF CHANGES IN THE PENSION SYSTEM

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## SUMMARY

### The Importance of the Assessment

Due to the demographic tendencies, Lithuania's population is ageing at the fastest pace in the European Union. The European Commission projects that, in 2050, more than half of Lithuania's population - people over 50 - will be participants of "the silver economy" and, because of the declining number of employed people, it will become harder to contribute to the support of elders; therefore, the source of social insurance payment will be relatively lower. To solve the problem of the population ageing, the retirement age is being increased – by 2026, it should be 65 years, as in many other countries of the EU. The Government Strategic Analysis Centre observes that the ageing population is related not only to potential challenges but also to new opportunities – a new market of goods and services along with conditions for establishing new labour market models are developing.

The ratio between the amount of the paid pension and wages earned is called the replacement rate. According to the European Commission, this index helps to assess the effectiveness of the social security system and shows how the pension replaces the wage that has been the main source of income before retirement<sup>1</sup>. The Organisation for Economic Co-operation and Development stressed that the retired population of Lithuania receives approximately one-third of the net wages earned before retirement – this is one of the poorest indicators among the countries of the organisation<sup>2</sup>. One in every four senior citizens faces the risk of poverty and Lithuania is among the four most vulnerable countries in the EU (only above Estonia, Latvia, and Bulgaria)<sup>3</sup>. In 2020, the risk

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<sup>1</sup> 2021 Pension Adequacy Report. Current and future income adequacy in old age in the EU. Volume 1, 2021.

<sup>2</sup> Pensions at a Glance 2021, OECD and G20 Indicators, 08/12/2021.

<sup>3</sup> Eurostat data. Internet access: [https://ec.europa.eu/eurostat/databrowser/view/IIC\\_LI04\\_custom\\_2573293/default/table?lang=en](https://ec.europa.eu/eurostat/databrowser/view/IIC_LI04_custom_2573293/default/table?lang=en) (accessed on 08/07/2022).

of poverty rate of Lithuanian retired people was one of the highest among the countries of the EU – 25 place out of 27. In Lithuania, it amounted to 39.5%<sup>4</sup>, while the average in the EU was 16.1%.<sup>5</sup> In 2021, the index slightly decreased to 38.8%.<sup>6</sup>

It is observed that retired persons remain in the labour market, while as they adapt to the newest technologies, their abilities and knowledge are useful to employers. Low pensions are the main reason why one in nine<sup>7</sup> retired persons are working<sup>8</sup>. Consistent additional savings for the pension with a more active contribution from employers or assurance of additional income by employing alternative methods may help people maintain living conditions that are close to the ones before retirement.

Understanding the importance of changes in the pension system and wanting to promote the adoption of targeted decisions regarding more active participation in the pension system to achieve a higher replacement rate and reduce the poverty in old age, the National Audit Office of Lithuania conducted an assessment.

## Objective and Scope of the Assessment

The assessment aims to provide structured information about the changes in the pension system and assess whether they are more oriented at the higher replacement rate or the reduction of poverty in old age.

Key areas of the assessment:

- social insurance retirement pensions;
- state and social assistance pensions;
- accumulation for pension in the second and third pillars.

Entities of the assessment: the Ministry of Social Security and Labour and the State Social Insurance Fund Board under the Ministry of Social Security and Labour (*Sodra*).

We collected information and organised meetings with scholars of Vilnius University, Prof. Dr Teodoras Medaiskis and Prof. Romas Lazutka, representatives of the Bank of Lithuania, Lithuanian Investment and Pension Funds Association, and the Ministry of Finance.

Assessed period: 2019–2021. To assess the changes, we examined data from the previous years (since 2004) and 2022.

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<sup>4</sup> The Lithuanian Department of Statistics data. Internet access: <https://osp.stat.gov.lt/lt/statistiniu-rodikliu-analize?hash=da8a49a9-089c-4ffd-a4f1-b794f669279e#/> (accessed on 08/07/2022).

<sup>5</sup> Eurostat data. Internet access: [https://ec.europa.eu/eurostat/databrowser/view/ILC\\_LI04\\_custom\\_2984143/bookmark/table?lang=en&bookmarkId=07e801d7-b9be-4fd4-ae6b-a36fa09a3aaa](https://ec.europa.eu/eurostat/databrowser/view/ILC_LI04_custom_2984143/bookmark/table?lang=en&bookmarkId=07e801d7-b9be-4fd4-ae6b-a36fa09a3aaa) (accessed on 08/07/2022).

<sup>6</sup> The Lithuanian Department of Statistics data. Internet access: <https://osp.stat.gov.lt/lt/statistiniu-rodikliu-analize?hash=da8a49a9-089c-4ffd-a4f1-b794f669279e#/> (accessed on 08/07/2022).

<sup>7</sup> According to the open data of *Sodra* of May 2022.

<sup>8</sup> Data of the Government Strategic Analysis Centre.

## Key Assessment Results

The changes in the Lithuanian pension system are more focused on poverty reduction, rather than the replacement of the former higher wages in old age to ensure living conditions that are close to the ones before retirement. The population is not motivated to pay more social insurance contributions in anticipation to receive a higher pension, while the additional accumulation of funds in the second and third pillars is not sufficient.

### The retirement pension system should encourage to pay more contributions

Since 2022, the general part of the pension share is not reduced for retired persons that have not accumulated compulsory work experience. According to case study data, in 2021, 23% of newly retired persons did not have accumulated compulsory work experience. These changes increased the lowest pensions by approximately 10%; however, this does not encourage future retired persons to work longer and accumulate work experience by paying state social insurance contributions (Sub-section 1.1, p. 11).

Based on case study data, in 2021, the general part of the pension, independent of paid contributions, on average accounted for 63% of the pension, while the individual part constituted 37%. For nearly 60% of the retired persons, the individual part of the share was lower than 37%. As there is no stronger link between contributions and benefits, participation in social insurance is only mandatory and unappealing to people paying more contributions (Sub-section 1.1, p. 11).

According to the data of the Ministry of Social Security and Labour, in 2020, on average retirement pension replaced 34.6% of wages<sup>9</sup>. Having calculated the replacement rates for the people that retired in 2021, we found that the pension replaces the smaller part of the previous wage for the people that paid more contributions: the rate was 68% for the people that earned up to EUR 500.9, 46.3% for the ones that earned around 1.5 of average wages, and 31.9% for people that earned more than EUR 3,005. An Increase in pensions for the people that do not have the minimum compulsory experience raised the replacement rate by 4.1 percentage points to 27%. The objective of the replacement rate – 50% – has been set while acknowledging average amounts; therefore, it will not grant more even replacement rates in all wage groups to maintain close living conditions to the ones before retirement and will not encourage to pay more contributions of state social insurance (Sub-section 1.2, p. 14).

In comparison to 2019, more people decided to receive the advance retirement pension in 2021, while the number of people among them, who have accumulated 40 and more years of work experience, increased by 4.4 times. More suitable conditions of advance retirement pension that came into force may have contributed to it. Based on the data of the case study, 87.9% of people received a pension that was below the risk of poverty threshold of 2021. 85.5% of people did not receive a wage from which contributions of social insurance are calculated, i.e. they were not employed, for more than a month before the advance retirement pension. Advance retirement pension should not be used as a tool for fixing the unemployment problems of elder people (Sub-section 1.3, p. 16).

<sup>9</sup> Lithuanian country fiche on pension projections 2021 Ageing Report. Internet access: <https://ec.europa.eu/info/sites/default/files/economy-finance/lt - ar 2021 final pension fiche.pdf> (accessed on 29/06/2022).

In 2021, social assistance benefits were increased for people that had reached the retirement age but did not have any income or received very small pensions; for example, the social assistance retirement pension was increased to EUR 143 but did not reach the cost of basic needs, which is EUR 260. While raising social assistance benefits, it is important to assess the stimulus to work of the people that receive them (Sub-section 1.4, p. 17).

To make the system of retirement pensions more appealing for the people paying more contributions, it is necessary to focus on contributions-based replacement of income before retirement. The problem of poverty of people that reached retirement age should be solved with measures of social assistance.

#### The restructuring process of state pensions needs a direction

In 2018, the results of the analysis of the state pension system, commissioned by the Ministry of Social Security and Labour and the European Commission, revealed problems related to different regulations (terms of granting and payment, base rates) and payments of these pensions along with retirement pensions, while suggestions to initiate restructuring were put forward; however, between 2019 and 2021, no systemic changes took place. The programme of the eighteenth Government stipulates that the system of all state pensions should be reorganised until Q2 2023, but in the plans of the Ministry for 2022, only the assessment of potential changes in the regulation of state pensions for officers and soldiers, victims, and judges and the identification of the direction of restructuring is intended. Measures affecting other state pensions, rents, or compensation benefits are not planned. Seeking a change, it is important to identify directions of restructuring covering the whole system and adopt targeted decisions without delay (Section 2, p. 19).

#### A greater contribution of the employers and clear benefits to the retired people would encourage them to additionally accumulate for the pension

The reform in 2019 contributed to the more effective performance of 2nd pillar pension funds: lifecycle funds were established, administration fees were reduced, sources of contributions were supplemented, a new system of benefits was established. However, objectives and indicators (number of active participants and employers that take part, replacement of wages before retirement with benefits) of additional accumulation for pension in the second and third pillars are not established in legislation and strategic documents. The real benefits of accumulation for retired people, such as how the amount of funds paid into the participant's account increased, the period of accumulation, the amount of paid benefits, and what is the replacement of income, are not assessed in the country. Analysis of factors that contributed to the accumulated amount is not being conducted (Sub-section 3.1, p. 22; Sub-section 3.4, p. 29).

Employers have the opportunity to contribute to employees' additional accumulation; however, based on the data of the Lithuanian Investment and Pension Funds' Association, in 2021, only 1.2% of employers contributed to the employees' additional accumulation for pension: in the second pillar – 13 employers, in the third – 1,324. The concept of the second pillar in Lithuania differs from other countries. In Denmark, Finland, The Netherlands or Sweden, around 80% of employers participate in the second pillar, which is an occupational pension scheme; participation in it is partly or fully compulsory, while in Lithuania, incentive state contributions are paid (Sub-section 3.3, p. 28).

An increase in the population that accumulates for the pension independently is visible. In 2021, 1,338 thousand people were participating in the second pillar – nearly 95% of all employed population; however, 47% did not pay contributions. At the same time, 79 thousand were participating in the third pillar, but 38% of them did not pay contributions. In 2021, 66% of new participants were added automatically. Frequent changes in the system did not contribute to the positive development of the system, as it did not increase the population's trust in it (Sub-section 3.1, p. 22; Sub-section 3.2, p. 25).

Participants of the accumulation mostly receive lump-sum benefits. In 2021, 72.6% of the participants in the second pillar that have retired, did not accumulate a sufficient amount of assets for periodic benefits; for example, due to the suspended payment of contributions; therefore, they received a lump-sum benefit. In the third pillar, all funds were paid in lump-sum benefits. 57.1% of the participants took their benefits before the retirement age; thus, their benefits were 3 times smaller than of those who have reached the retirement age. A lump-sum benefit does not ensure a bigger pension in old age, as it may be spent at once (Sub-section 3.4, p. 29).

In the second pillar, the number of people that have accumulated EUR 10 thousand or more and have bought pension annuities is increasing. In 2021, there were 993 beneficiaries. The average annuity paid by *Sodra* was EUR 63, while the highest was EUR 339. According to the data from the case study, on average annuities replaced 3% of beneficiaries' previous wages. Replacement of income for the people that have accumulated more is greater: 8.7% for people that have accumulated 60 thousand or more; 2.5% for people that have accumulated up to EUR 15 thousand. In 2021, pension annuities amounted to 9.1% of the beneficiaries' retirement pension (Sub-section 3.4, p. 29).

To receive a bigger pension in old age, it is important to accumulate consistently; therefore, the state needs to set objectives for pension accumulation, establish target indicators and measures to achieve them, improve the population's financial literacy, promote occupational pensions, and publicly publish about the real benefits of accumulation for the retired people.