INTERNATIONAL MONETARY FUND

Ensuring Adequate and Affordable Pensions in Latvia

Keyra Primus

SIP/2025/134

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on July 31, 2025. This paper is also published separately as IMF Country Report No 25/273.

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SELECTED ISSUES PAPER

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IMF Selected Issues Paper
European Department

Ensuring Adequate and Affordable Pensions in Latvia, Republic of Latvia

Prepared by Keyra Primus

Authorized for distribution by Luis Brandao-Marques
October 2025

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ABSTRACT: Latvia has a three-pillar pension system consisting of an earnings-related public scheme, a funded mandatory pillar, and a private voluntary contributions pillar. Despite its well-designed structure, the system faces challenges in ensuring adequate retirement income and curbing old-age poverty. This paper outlines policy options to improve pension adequacy and address future pressures on pension spending, including raising revenues, reorienting and rationalizing spending, increasing the contribution rates and the returns to the mandatory defined contribution pension pillar, and strengthening incentives for higher voluntary savings for retirement. A comprehensive strategy, including active labor market policies, is also essential to address the effects of population aging and improve pension adequacy.

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SELECTED ISSUES PAPERS

Ensuring Adequate and Affordable Pensions in Latvia

Latvia

Prepared by Keyra Primus[1]

[1] The author would like to thank Luis Brandao-Marques, Boele Bonthuis, Helge Berger, and the Latvian Authorities for their helpful comments; and Can Ugur for excellent research assistance.

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REPUBLIC OF LATVIA

SELECTED ISSUES

July 31, 2025

Approved By
European Department

Prepared By Keyra Primus

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ENSURING ADEQUATE AND AFFORDABLE PENSIONS IN LATVIA[1]

Latvia has a three-pillar pension system which combines an earnings-related public scheme, based on notional accounts, with a funded mandatory pillar and a private voluntary contributions pillar. Despite the well-designed model, Latvia's current pension system may be unable to provide some of its citizens with adequate retirement income and curb old-age poverty. Improving pension adequacy and meeting societal expectations require strengthening the second and third pension pillars and raising public spending on pensions in the future—which will add to medium- and long-term spending pressures. The government could improve pension adequacy and address future pressures on pension spending by raising revenue, reorienting and rationalizing spending, increasing the contribution rates and the returns to the mandatory defined contribution pension pillar, and strengthening incentives for higher voluntary savings for retirement. A comprehensive approach should also be adopted to help cushion the effects of population aging and improve pension adequacy, including by pursuing active labor market policies to increase labor force participation, incentivizing pensioners to work, and linking the retirement ages to future life expectancy gains.

A. Pension System Overview

1. Latvia's pension system is made up of three-pillars—two mandatory and one voluntary pillar and it covers most employees and self-employed.[2] Hence, contributory pensions in Latvia are based on notional and individual accounts.[3] The pillars are as follows:

- *The first pillar (pillar I) is a state compulsory and unfunded pension scheme.* It is a pay-as-you-go (PAYG), notional defined-contribution (NDC) system with nearly universal coverage.[4] Under pillar I, pension contributions are tracked with a notional account, similar to a mandatory funded defined contribution (DC) scheme, except that the account is not funded and the contributions are used instead to fund payouts to current retirees. At retirement, the notional account is turned into a lifelong pension (annuitized). Participation in the pillar I arrangements is mandatory for all

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[2] Self-employed persons with income lower than the minimum wage contribute 10 percent of their income (compared to the 20 percent rate for employees). The self-employed having income at least at the minimum wage or exceeds it, contribute for the old age pension the 20 percent from a freely chosen object, which is not smaller than the amount of the minimum wage, and 10 percent from the difference of the income and the freely chosen object (OECD, 2023).

[3] The pension value is the sum of notional capital at retirement (contributions uprated in line with the covered wage bill) divided by the 'G-value' (calculated annually using projected life expectancy at retirement age with a unisex life table).

[4] In pillar I, the social insurance contributions earmarked for old-age pensions are recorded in notional individual accounts, with a theoretical rate of return applied until retirement so that a (notional) pension capital is accumulated.

employed and self-employed people over the age of 15 and offers payouts to all participants who have reached the statutory minimum retirement and contributed for at least 20 years. [5,6] Pensions are indexed to inflation plus 50-80 percent of real wage growth, which puts downward pressure on the benefit ratio.[7]

- *The second pension pillar (pillar II) is a mandatory fully-funded defined contribution (FDC) pension scheme* that complements retirement income provided by the first pension pillar.[8] Persons born after July 1, 1971, and who are at least 15 years old are automatically registered for it. The growth or reduction of value of the pension capital in the second pillar depends directly on the performance of the selected pension plan as well as the investment strategy and structure of its financial instruments (e.g., deposits, bonds, equities). The investment objective is to ensure that pension capital would grow faster than inflation and the average salary in the country. Accumulated money along with the pension of the first pension pillar will give persons additional income in old age. The funded part of the mandatory system (second pension pillar) is state administered (by the same agency as the NDC); only the investment is privately managed, while keeping track of contributions, entitlements, and eventually benefit payments is handled public.
- *The third pension pillar (pillar III), which was launched in July 1998, is the voluntary private pension scheme.* Part of the person's income is invested in private pension funds by the individual personally or by his/her employer. The amount of money individuals and their employers regularly pay into the pension fund is invested in different financial instruments, including equity funds, government/ corporate bonds, and term deposits. The pension under the third pillar can be received from the age of 55 (i.e., before reaching retirement). This pillar gives the opportunity to create additional voluntary savings in addition to the state-guaranteed first pillar and the mandatory DC second pension pillar.

2. The Latvian three-pillar pension system creates a more robust and flexible retirement. Having a three-pillar system reduces dependency on a single source, making the system more resilient to economic shocks or demographic changes. The three-pillar system also spreads risks across different sources and reduces pressure on public budgets by combining PAYG public pensions with funded occupational and private schemes. The voluntary pillar allows workers to accumulate additional savings and improve their standard of living after retirement beyond the

[5] The minimum insurance period was increased to 20 years effective 1 January 2025. Minimum pensions are granted to people who fulfill the 20-year contribution condition for regular pensions. A person who has an insurance period below the minimum insurance record (or no insurance record) and has reached the statutory retirement age is granted the state social security benefit (Ministry of Welfare of Latvia, 2023).

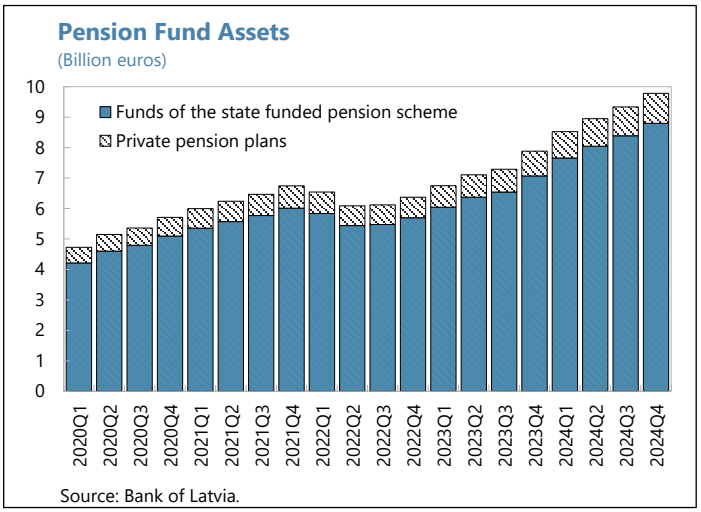
[6] In Latvia, service pensions are also granted to beneficiaries with a special status, such as state employees working in difficult conditions (aviation workers, artists), security and defense forces (military, police), and justice workers (judges, prosecutors). These workers have special privileges such as lower retirement age and reduced or more favorably counted minimum or full contributory period (Eckefeldt and Patarau, 2020).

[7] The benefit ratio is the average pension benefit divided by the average wage.

[8] In the 2025 budget, contributions equivalent to 1 percent of GDP from pillar II were diverted to the unfunded public system (pillar I). The diversion of contributions has helped to reduce the projected fiscal deficit in the near term but could worsen the long-term fiscal outlook.

basic public pension. This helps foster a culture of long-term financial planning and reduces moral hazard of relying solely on public pensions.

3. Government spending on pensions has been relatively stable in recent years. Over the last 5 years, pension spending as a share of GDP has been 7.9–8.7 percent for most years, except 2023 when it increased to 10 percent of GDP due to high inflation. The social insurance contribution rate for the state old-age pensions (i.e., NDC + FDC) is 20 percent of the gross wage.[9] The pension received at retirement age is directly related to the contributions made by individuals in each of the levels, with those who contribute more or delay retirement receiving a larger pension. Effective January 2025, the retirement age for both men and women is 65 years.[10]



4. Latvia's pension fund assets have grown, despite low returns. Latvia's second pillar pension assets currently amount to almost EUR 8.8 billion (21.9 percent of GDP or 51 percent of the total assets of the nonbank financial sector), while the assets in the third pillar amount to almost EUR 1 billion (2.5 percent of GDP or 5.7 percent of the total assets of the nonbank financial sector) (Bank of Latvia, 2025). Previously, there were constraints on the amount of assets permitted to be invested in equities. As a result of these constraints, most assets were invested in relatively low-yielding, short-term government bonds and term deposits with maturities of one to three years (Volskis, 2014). Over the last 10 years, the nominal average annual return on pension assets was around 2 percent, which was below wage growth, depressing expected income replacement rates in the long term. Staff's analysis shows that the low rate of return is a key factor behind the projected decline in replacement rates[11]. Ongoing reforms to pension enrollment that make a life cycle plan the default option could contribute to higher returns and improve pension adequacy in the future. Recent data show most assets of the second and third pension pillars are invested in investment certificates and similar securities (Figure 1). Recent efforts taken by the Bank of Latvia to reduce management fees charged by pension fund managers resulted in savings of 0.2 percent of GDP. The measure differentiates traditional from alternative investments and could provide some incentives for pension managers to increase allocations for longer-term investments capable of generating higher returns over time.

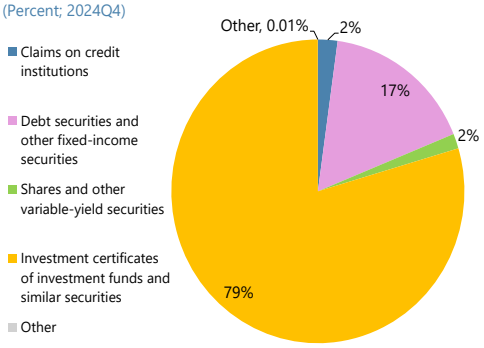
[9] Employees pay 7.5 percent of their salary for pensions and employers pay 12.5 percent. Of the 20 percent, 15 percent is allocated to the PAYG system (pillar I) and 5 percent to the funded mandatory system (pillar II).

[10] Since 1 January 2014 the retirement age has been increasing by three months every year and is 65 years effective 1 January 2025.

[11] The replacement rate is the ratio of the first pension of those who retire each year over an economy-wide average wage at retirement.

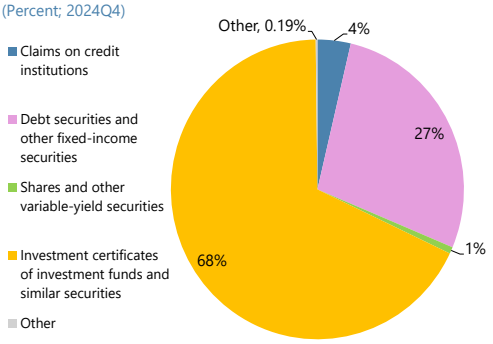
Figure 1. Latvia: Asset Composition of Pension Plans

Asset Composition of the State Funded Pension Scheme
(Percent; 2024Q4)



Source: Bank of Latvia.

Asset Composition of Private Pension Plans
(Percent; 2024Q4)



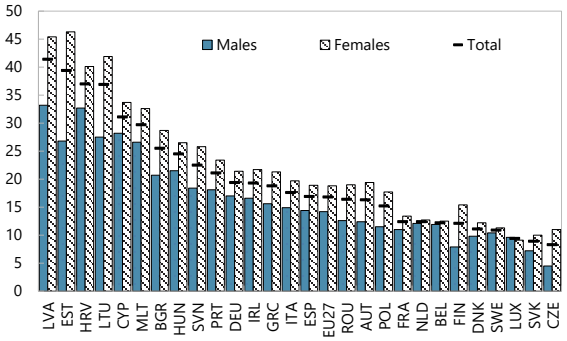
Source: Bank of Latvia.

B. An Assessment of Pension Adequacy

5. Latvia's pension system is facing the challenge of being able to provide citizens with an adequate income in retirement and reduce poverty. For Latvia, the current low and declining benefit ratio could have an impact on pension adequacy, defined as the extent to which pension benefits suffice to ensure retirees a descent standard of living and protect them from poverty. There is the concern that retirement income of people at the lower end of the income distribution will be low, which would contribute to the continuation of a high level of old-age poverty. In Latvia, the relative old-age poverty rate is high and rising, especially among those older than 75 years and among women (OECD, 2018; EC, 2024c) (Figure 2). Latvia's 65+ at-risk-of-poverty rate is in line with Estonia, but it has been above Lithuania and the euro area average over the last decade. In 2024, Latvia had the highest 65+ at-risk-of-poverty rate in the EU (see Pape, 2023; Figure 2).

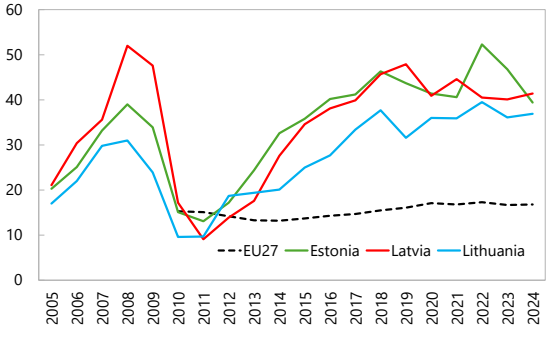
Figure 2. Baltics: At-Risk-of-Poverty Rate of Population

At-Risk-of-Poverty Rate of Population Aged 65+, 2024
(Percent)



Source: Eurostat, EU-SILC dataset.

At-Risk-of-Poverty Rate of Population Aged 65+
(Percent)

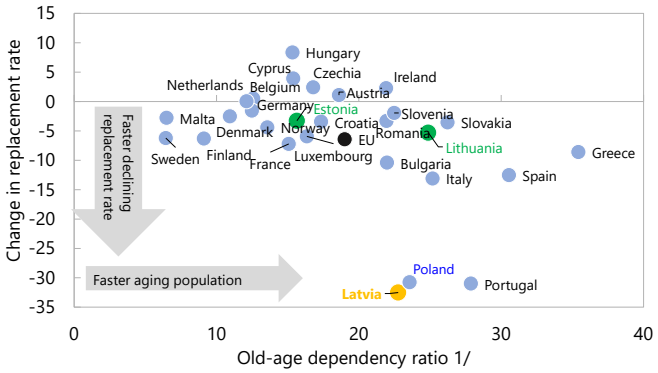


Source: Eurostat, EU-SILC dataset.

Note: Cut-off point is 60% of median equivalised income after social transfers.

6. Given the low replacement rates, recent reforms to the pension system aimed at addressing poverty have not been able to provide adequate support to pensioners. Reforms to address poverty have been directed to pensioners who receive low old-age pensions, survivor pensions and to persons with disabilities and recipients of low disability pensions, as well as social insurance benefit receivers (Ministry of Welfare of Latvia, 2023; EC, 2024a). Since July 2023, the amount of social security benefits and bases for minimum pensions amount were linked to the income median and revised each year.[12] While recent pension reforms have tended to improve or maintain pensions' role in protecting against poverty, most reforms will result in lower replacement rates in the future, and in turn a general decline in pension entitlements from public pension schemes. Based on the EC's 2024 Ageing Report, Latvia's replacement rate (pillar I) is projected to decline from 56 percent to 24 percent during 2022-2050, the largest decline among EU states (Figure 3).[13]

Population Aging and Falling Pension Replacement Rates
(Percentage points, projected change during 2022-50)

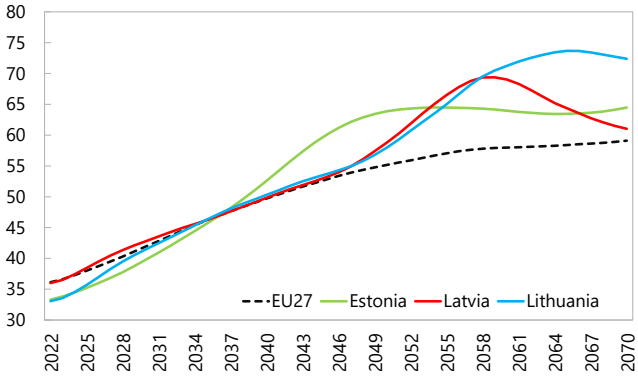


Source: EC 2024 Ageing Report.
1/ Defined as the ratio of persons aged 65 and older to persons aged 20-64.

C. Pension Projections

7. Over the next few decades, Latvia's population is projected to age rapidly. The population is projected to continue shrinking by a third between 2022 and 2070, one of the fastest population decreases in the EU. Unlike in many countries in Western Europe, where population aging is happening because of increases in life expectancy,[14] population aging in Latvia is happening because of low fertility and high emigration of young people. The projected demographic changes are

Old-Age Dependency Ratio 1/
(Percent)



Source: EC 2024 Ageing Report.
1/ Defined as the ratio of persons aged 65 and older to persons aged 20-64.

[12] The minimum income thresholds, set as a percentage of the median income, are different for different social groups, are subject to different coefficients, and vary according to the specific disability group for the person and whether a disabled person is employed. Previously, the minimum income threshold was set in euros.

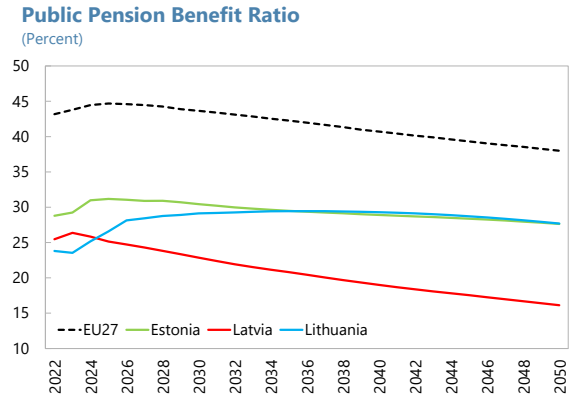
[13] From the poverty alleviation perspective, the absolute adequacy requires a replacement rate set at a level that avoids at least extreme poverty (while at the same time is not too high to undermine incentives to contribute to earnings-related public pension systems (IMF, 2022)).

[14] Life expectancy in Latvia is low (second lowest in Europe after Lithuania). Cumulative net migration in 2019-2070 is also projected to be negative for Latvia (EC, 2021).

expected to result in fewer people in all age groups except the oldest ones, thus leading to a rapid increase in the old-age dependency ratio in the long run from 36 to 61 percent over 2022-2070. In addition to a direct effect on government spending with pillar I pensions, the increase in the dependency ratio over time will also put upward pressure on public health care costs. Moreover, as the population ages further, the ability of the pension system to deliver adequate retirement income will become increasingly important for the median voter.

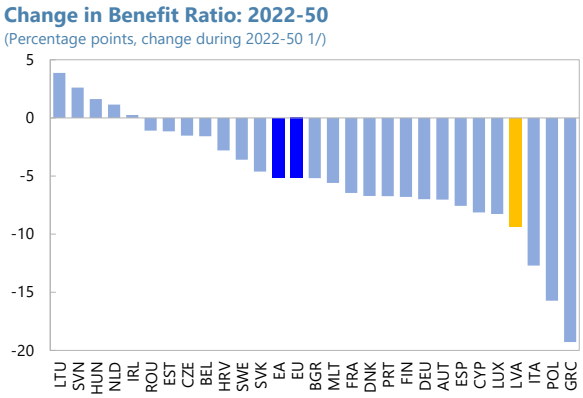
Figure 3. Latvia: Benefit Ratio and Replacement Rate

Latvia's benefit ratio is projected to decline more than the other Baltics and EU average...



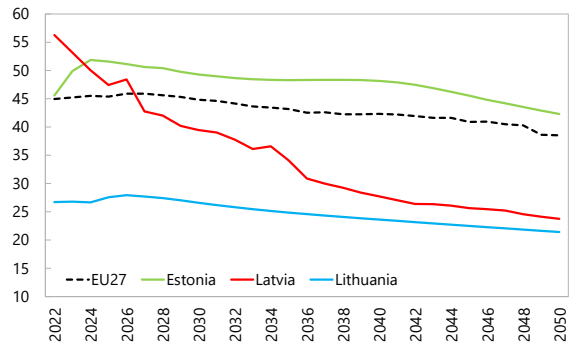
Source: EC 2024 Ageing Report.

...so the change in the benefit ratio is one of the highest in EU countries.



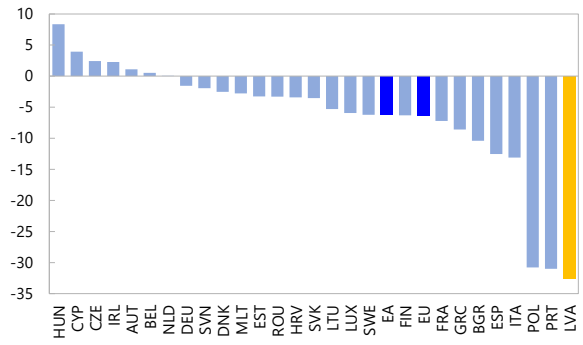
Source: EC 2024 Ageing Report.

The gross replacement rate is projected to decline rapidly...



Sources: EC 2024 Ageing Report.

...and has the largest overall decline among EU countries.

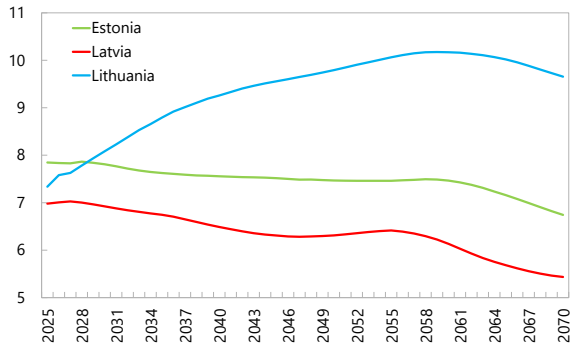


Source: EC 2024 Ageing Report.

8. Efforts to ensure fiscal sustainability through reduced pension spending often conflict with social sustainability by undermining the financial well-being of retirees. Despite worsening demographics, pension spending is projected to decline due to the declining benefit ratio. In the NDC system, the negative impact of demographic change on pension expenditure is primarily offset by the decline in pension benefits. Thus, the EC's 2024 Ageing Report projects a decline in the gross public pension expenditure-to-GDP ratio in Latvia from 7 percent of GDP in

2025 to 5.4 percent of GDP in 2070, more than the other Baltics. The decline in the benefit ratio and replacement rate of Latvia's public (PAYG) pillar is due to switching part of the public old-age scheme into privately funded schemes, so public provision decreases while the private mandatory part increases (Ministry of Welfare of Latvia, 2023; Figure 3). This decline in pension spending may not be sustainable given possible concerns about the adequacy of pension income for people relying on public pension. The drop in public pension expenditure in the future would also worsen the adequacy of overall income protection for older people. These developments, in turn, will increase social pressure on the state pension system.

Pension Spending in the Baltics
(Percent of GDP)

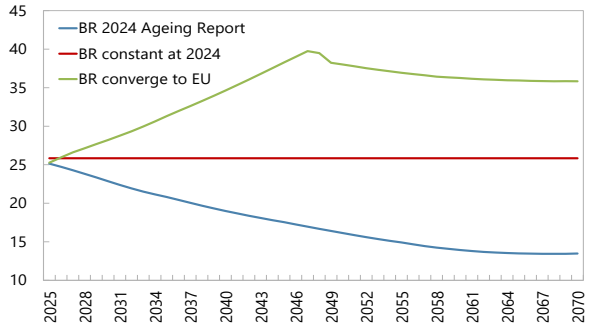


Source: EC 2024 Ageing Report.

Figure 4. Latvia: Implied Pension Expenditures, Fiscal Balance, and Public Debt Under Different Benefit Ratio (BR) Scenarios

The benefit ratio in EC's 2024 Ageing Report is projected to decline for Latvia in the coming decades…

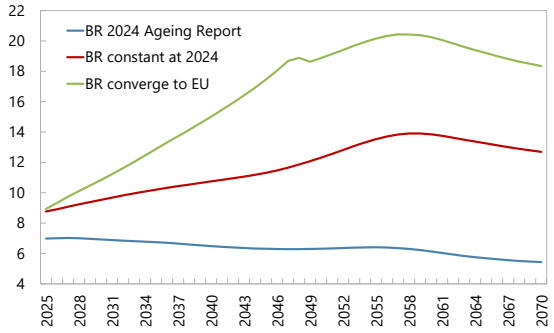
Benefit Ratio Scenarios
(Percent)



Sources: EC 2024 Ageing Report; and IMF staff calculations.

…causing a decline in pension spending.

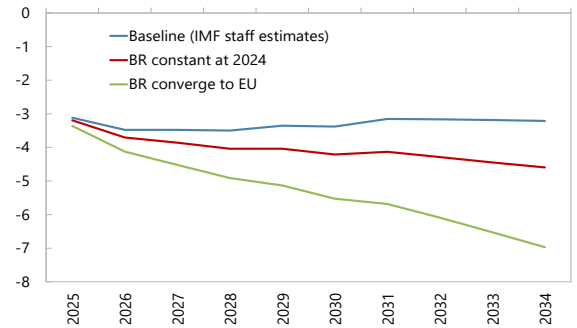
Implied Pension Spending
(Percent of GDP)



Sources: EC 2024 Ageing Report; and IMF staff calculations.

A constant/ higher benefit ratio will cause the fiscal deficit to breach the 3 percent of GDP target in the medium term.

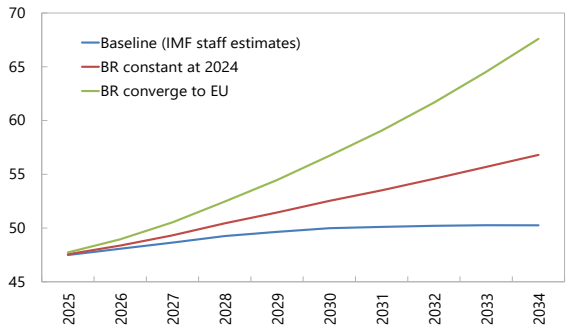
ESA Fiscal Balance
(Percent of GDP)



Sources: EC 2024 Ageing Report; and IMF staff calculations.

Public debt will exceed the 60 percent of GDP target if the benefit ratio converges to the average EU benefit ratio.

Public Debt
(Percent of GDP)



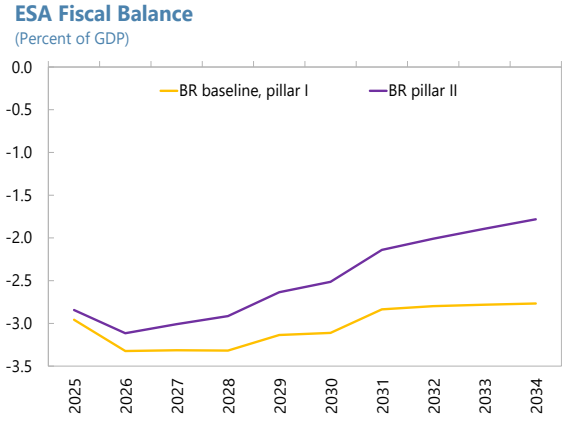
Sources: EC 2024 Ageing Report; and IMF staff calculations.

9. In various illustrative scenarios that consider only pillar I, government spending on pensions as a share of GDP is projected to increase substantially. Staff's estimates show that if the benefit ratio is projected to remain at the 2024 level, the fiscal deficit is projected to increase from 3.7 percent of GDP in 2026 to 4.6 percent of GDP in 2034, while public debt will increase from 48.4 percent to 56.8 percent of GDP over the same period (Figure 4). In the scenario where Latvia's benefit ratio converges to the average EU benefit ratio, the fiscal deficit will increase from 4.1 percent to 7 percent of GDP over 2026-2034. Public debt will increase from 49 percent to 67.6 percent of GDP over 2026-2034. Overall, using a more realistic benefit ratio will put pressure on the fiscal deficit and debt.

10. If pillar II is considered, higher pension expenditures will still worsen key fiscal targets, though to a lesser extent than under pillar I only. To better assess the impact on the fiscal balance and public debt of aiming at a cost benefit ratio, the previous analysis is expanded with an illustrative scenario that includes pillar II benefit ratio.[15] The analysis shows that if pillar II benefit ratio is considered, pension income is higher in the medium term than under pillar I benefit ratio only, which reduces the burden on the latter. In this case, the fiscal deficit (public debt) is about 0.4 percent (0.9 percent) of GDP lower on average in the medium term (Figure 5). The difference between pillar I and pillar II is an estimate of how much the government could save in pension spending, given that pillar II is expected to address the adequacy gap. Still, although pillar II will help individuals to accumulate additional funds for retirement and reduce the adequacy gap, it is not sufficient to substantially lower medium- and long-term pressures on pension spending in the face of Latvia's aging population. Therefore, it is essential to further strengthen pillar II by increasing contributions and returns.

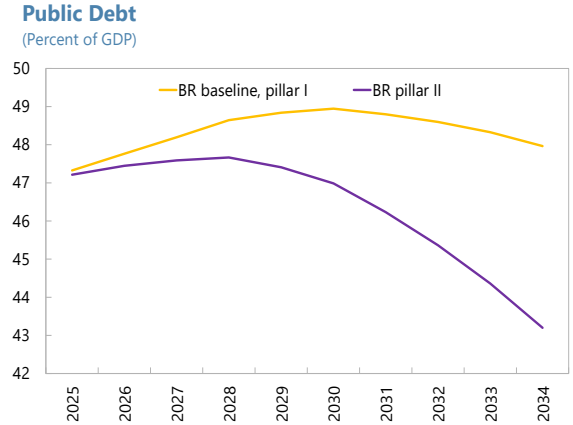
Figure 5. Latvia: Fiscal Balance and Public Debt Under Pillar I vs Pillar II

If pillar II is considered, the deficit is lower than the scenario with pillar I.



Sources: EC 2024 Ageing Report; and IMF staff calculations.

Public debt is also lower in the scenario with pillar II.



Sources: EC 2024 Ageing Report; and IMF staff calculations.

[15] In this scenario, the projected benefit ratio in EC's 2024 Ageing Report is used for pillar I.

D. Conclusions and Recommendations

11. The Latvian multi-pillar pension system is a well-designed model that should be kept. Multi-pillar designs provide more flexibility than mono-pillars and are therefore typically better able to address the needs of the main target groups in the population and provide more security against the economic, demographic, and political risks faced by pension systems (The World Bank, 2005). Having privately funded pensions helps to build up private pension income to enhance the adequacy of pensions, particularly where public pension schemes offer low replacement rates (Fouejieu and others 2021). However, Latvia's demographic situation poses significant challenges to the future sustainability of the system.

12. The authorities should strengthen the second and third pillars of the pension system to improve pension adequacy. The mandatory and voluntary defined-contribution pillars of Latvia's pension system need to be strengthened to guarantee adequate pensions and reduce the financial burden on the public pension system in the future by:

- *Increasing the contribution rates to mandatory defined contribution pension pillar.* Increasing payments to the mandatory defined contribution pension pillar could raise allocations to pension capital and prevent an excessive reduction of pensions compared to salaries without raising fiscal pressures.
- *Increasing the returns to pillars II and III.* The asset composition of retirement savings should be changed to include more equity and other long-term investments. A prudent increase in the share of equities and alternative investments in the asset composition of retirement savings would increase returns.
- *Strengthening incentives for higher voluntary savings for retirement through a more flexible and accessible system design.* The third pillar will need to play a key role in covering a large part of the gap in adequacy and hence maintaining the future adequacy of pensions. In Latvia, the voluntary pension pillar is mainly used by middle-to-high income households. The government could promote enrollment in the third pillar by providing tax incentives to businesses that offer pillar III to their employees. Another option is to auto-enroll people into the voluntary pension schemes, with the possibility to opt out.

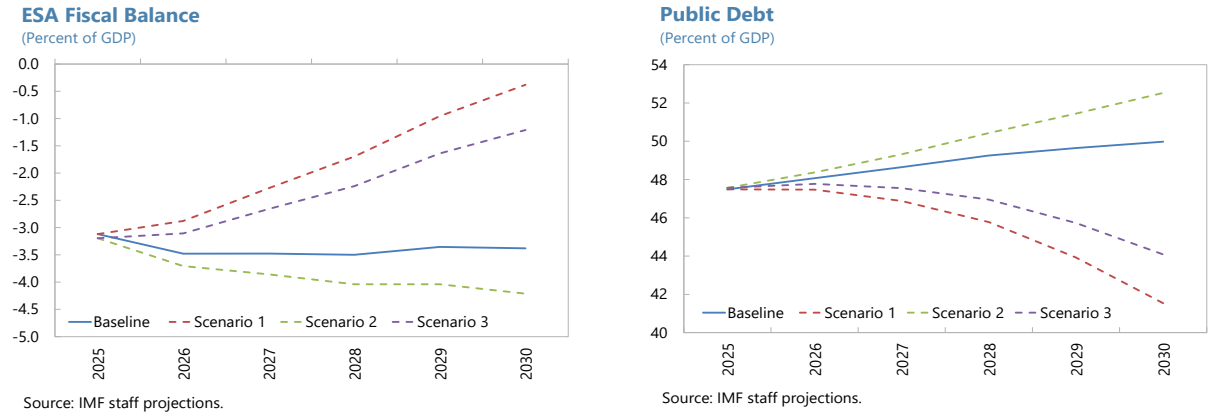
13. The government should also build buffers to support medium- and long-term pressures arising from higher pension spending with pillar I. Staff's estimates show that revenue and spending measures could deliver 3 percent of GDP over 2026-2030. Proceeds from these measures could help to relieve both current and medium- and long-term spending pressures and ensure fiscal sustainability (Figure 6).

- ***Raising revenue -*** One possible source of financing is revenue, given Latvia's low total tax receipts to GDP ratio (22 percent of GDP vs an average of 26 percent of GDP for the EU in 2023) and gaps in revenue administration. These measures include:
  - *Continuing to improve VAT collection efficiency through further narrowing of the compliance gap:* VAT revenue serves as one of the core revenue sources for Latvia. In 2024, the VAT

revenue-to-GDP ratio amounted to 9.7 percent of GDP, which makes VAT essential for financing the provision of public goods and services. Although Latvia decreased its VAT compliance gap by almost 20 percentage points between 2013 and 2022, preliminary estimates showed that the gap increased in 2023 and remained high at 8.9 percent (EC, 2024b). There is scope to increase revenue by continuing to improve VAT collection efficiency in Latvia, which could be due to tax compliance and concessions granted through exemptions.

- *Broadening the bases of corporate and personal income taxes by reducing the shadow economy:* Although Latvia's informal sector reduced, it still remains large (21.4 percent of GDP in 2024[16]), which presents a barrier to longer-term government objectives and is seen by the business community as distorting the competitive environment. Measures should be adopted to reduce the shadow economy, including identifying and registering businesses and individuals operating outside the tax system, reducing tax evasion, and controlling abuses in employment related taxes.
- *Reducing tax exemptions and fossil fuel subsidies*: Tax exemptions are high in Latvia (7.7 percent of GDP) compared to Estonia (0.9 percent of GDP), and Lithuania (4.2 percent of GDP). There is therefore scope to reduce exemptions to raise revenue.
- *Increasing property tax revenue*: Latvia collects less than the euro area average in property tax revenue (about 0.6 percent vs 1.1 percent of GDP). Therefore, the government could increase revenue by updating cadaster values with market prices, reducing property tax exemptions, and raising the property tax rate. Policies to increase the property tax rate should be matched with options to support low-income households.

Figure 6. Latvia: Fiscal Balance and Public Debt Scenarios



Source: IMF staff projections.

Source: IMF staff projections.

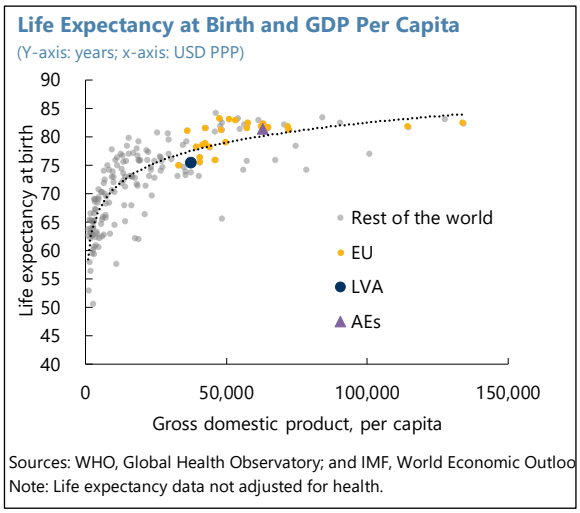
Note: The baseline includes an increase in defense spending from 4 percent of GDP in 2025 to 5 percent of GDP in 2026. Scenario 1 incorporates revenue and expenditure measures of 0.6 percent of GDP per year (2026-2030). Scenario 2 includes higher public spending due to pensions (assuming a constant benefit ratio). Scenario 3 combines scenarios 1 and 2 (higher spending on pensions with revenue and expenditure measures).

[16] See Sauka and Putniņš, 2024.

- ***Reorienting and rationalizing spending -*** Public spending could be reoriented by reallocating funds away from lower priority spending on goods and services. The government should also consider improving the efficiency of public spending by further improving procurement, eradicating rent-seeking activities, simplifying regulation, reducing bureaucracy, and increasing the efficiency of public administration.

14. The authorities should also consider other structural measures to increase payments to the pension system and reduce outlays that explicitly cushion the effects of population aging. The following measures that increase the size of the workforce could improve pension adequacy, while ensuring the pension system's financial sustainability.

- ***Pursuing active labor market policies to increase labor force participation:*** Policies should be adopted to counteract the expected decline in the labor force, including raising human capital by investing in education, promoting access to childcare to support an increase in female labor force participation (Amaglobeli and others 2019), and attracting qualified individuals to work in Latvia.
- ***Incentivizing more pensioners to work:*** Although Latvia has a high number of pensioners in the workforce, policies could be developed to encourage more pensioners to work after retirement (e.g., by enhancing education for older persons) to improve pension adequacy and help to compensate the potential hardships imposed on low-income individuals. Health life expectancy in Latvia is quite low compared to the EU average. Therefore, more investment in the health sector would be required to ensure that older people remain healthy and capable of working at later ages. Healthier aging could help to boost labor supply by extending working lives and enhancing workers productivity (IMF, 2025). Implementing measures to extend health life expectancy are important to make retirement reforms that encourage delayed retirement both sustainable and humane (Centre for Economic Policy Research, 2024).



- ***Linking the retirement ages to future life expectancy gains:*** Linking the statutory pension age to life expectancy is an effective strategy for balancing the sustainability and adequacy of pension systems in the context of aging populations.[17] This policy would also help to slow the inflow of new retirees which could help to attenuate long-term fiscal vulnerabilities (Amaglobeli and others 2020). By making it clear that longer life expectancy requires longer working lives to support the pension system, this approach creates strong incentives to delay retirement in line with increased

[17] Linking the retirement age to the increase in life expectancy would increase the number of contributors, decrease the number of pensioners, and result in a larger accumulated pension capital and higher average pension (Ministry of Welfare of Latvia, 2023).

longevity. Additional reforms could include linking the official and early retirement ages to future life expectancy gains to encourage longer work lives once the retirement age reaches 65.

15. To enhance adequacy and reduce pension spending, reforms should foster higher productivity growth. The government should also increase productivity growth and the efficiency with which resources are allocated economy wide to help reduce pension spending. Higher productivity leads to greater economic growth, which in turn increases government revenues from taxes, providing more funds to support public pension systems without needing to raise contribution rates or cut benefits. Latvia can boost productivity growth by enhancing allocative efficiency and firm dynamics (see SIP on "Allocative Efficiency, Firm Dynamics, and Productivity in Latvia").

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