Lithuania struggles to finance its public pensions

By Editor Test *Wed, Nov 28, 2012*

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Lithuania's lame duck parliament (Seimas) has passed a package of long-planned pension reforms, even though recent elections gave a majority to a center-left coalition, *IPE.com* reported. The outgoing legislators approved the measures and the president is expected to sign them.

At present, employees who make "second-pillar" provisions—deferrals to defined contribution plans—can redirect a percentage of their social tax contributions into personal accounts with their private pension funds, instead of paying the full amount into the pay-as-you-go national pension, known as SODRA.

As a result, they will get a smaller monthly retirement check from SODRA, but income from the second-pillar pension will make up for it. The current level of contributions to the second-pillar is 1.5% of salary, and it should increase to 2.5% in 2013.

The new laws will change that by reducing contributions to 2% of salary in 2014, but allow participants to add 1% of their after-tax salary income if they wish. The government would contribute an additional 1% of the statistical average national salary.

Pension fund members who entered the system before 2013 must notify their pension fund provider between April and September next year if they want to contribute more. The new members of the second pillar who join the system after 2013 will automatically enter the new system, which requires them to make additional personal contributions, to be topped up by a state subsidy.

Alternatively, the new law says that, during the same period, workers may stop paying into their second-pillar pension and rely more on the state PAYG system.

A member who does not take any action regarding these changes in 2013 will remain within the original set-up, where part of their social taxes get redirected to a private account in the pension fund of their choice.

The changes also provide that the additional contributions will increase to 2% of the member's actual salary after 2016, with a government top-up of 2% of the average national salary.

"These new legal amendments are marginally beneficial for second-pillar pension fund members, especially to those earning salaries close to or lower than average – mainly because they provide more choice and offer some incentives," said Marijus Kalesinskas, chairman of the Lithuanian Pension Fund Members Association.

"On the other hand, they make the pension system even more complicated and hard to understand for the average member – and indeed mix up the principles of the existing second and third pillars into one."

Other proposals include reducing the maximum fees that pension fund managers can charge from the current level of 1% of assets per year to 0.65% for the conservative (government bond only) pension funds after 2013. Fees for funds with investment policies that allow some risky assets will be left at 1% a year.

Last December, parliament approved measures to cut second-pillar contributions 1.5%.

Contributions had previously gone as high as 5.5%, before an initial reduction to 3% in 2008. The government said the cuts, meant to help reduce the budget deficit, would only be temporary.

At end-2010, the LAPF sued the government for compensation amounting to the value of extra contributions that would have been transferred to the private plans had the percentage remained at 5.5%. LAPF said the cuts were potentially against human rights and unconstitutional.

The lawsuit was eventually passed from the lower courts to the country's Constitutional Court, which issued a statement in June this year; this has since been subject to interpretation. Kalesinskas said that the LPFMA would take a decision within the next few months as to whether to pursue further action, including possibly applying to the European Court of Human Rights in Strasbourg.