



THE CONSTITUTIONAL COURT OF THE REPUBLIC OF LATVIA

JUDGEMENT

ON BEHALF OF THE REPUBLIC OF LATVIA

Riga, 25 January 2012

Case No. 2011-08-01

The Constitutional Court of the Republic of Latvia composed of the Chairperson of the court hearing Gunārs Kūtris, Justices Kaspars Balodis, Aija Branta, Kristīne Krūma, Uldis Ķinis and Sanita Osipova,

having regard to an application submitted by twenty Members of the Saeima of the Republic of Latvia— Andrejs Klementjevs, Valērijs Agešins, Ivans Ribakovs, Sergejs Mirskis, Nikolajs Kabanovs, Aleksejs Burunovs, Dmitrijs Rodionovs, Aleksandrs Jakimovs, Ņikita Ņikiforovs, Valērijs Kravcovs, Aleksejs Holostovs, Jānis Tutins, Artūrs Rubiks, Igors Meļņikovs, Vladimirs Nikonovs, Aleksandrs Sakovskis, Igors Pimenovs, Vitālijs Orlovs, Sergejs Dolgopolovs and Valentīns Grigorjevs (hereinafter – the Applicant) – on initiation of a case,

according to Article 85 of the Satversme of the Republic of Latvia and Para 1 of Section 16, Para 3 of Section 17 and Section 28¹ of the Constitutional Court Law

on 10 January 2012 examined in writing the case

“On Compliance of Section 4(1) of the Law on State Funded Pensions with Article 1 and Article 109 of the Satversme of the Republic of Latvia.”

The Facts

1. The Saeima of the Republic of Latvia (hereinafter – the Saeima) on 17 February 2000 adopted the Law on State Funded Pensions (hereinafter – the Law on Funded Pensions), which came into force on 1 July 2001. The Law on Funded Pensions sets out the general principles for establishing and operating the state funded pension scheme (hereinafter – funded pension scheme), rules on contributions, administration, management, investment and payment of funds, as well as State supervision of such activities.

Section 4(1) of the Law on Funded Pensions initially provided:

“Contributions to the funded pensions scheme shall be part of the contributions for State pension insurance.“

On 20 December 2010 the Saeima adopted a law as part of the draft state budget law package “Amendments to the Law on State Funded Pensions“, which came into force on 1 January 2011. With this Law Section 4(1) of the Law on Funded Pensions was expressed as follows:

“Contributions to the funded pension scheme shall be part of the actually made contributions for State pension insurance.“

On 20 December 2011 the Constitutional Court pronounced Judgement in Case No. 2011-03-01 “On Compliance of Section 5 (4) and Section 21 (2¹) of the Law “On State Social Insurance” with Article 1 and Article 109 of the Satversme of the Republic of Latvia” (hereinafter – Judgement in Case No. 2011-03-01), in which it established: the contested norms of the case, which envisage a person’s rights to certain social insurance services only if the compulsory state social insurance contributions (hereinafter – social insurance contributions) have been actually made, comply with Article 1 and Article 109 of the Satversme of the Republic of Latvia (hereinafter – the Satversme).

2. The Applicant – **twenty members of the 10th Saeima** – holds that Section 4(1) of the Law on Funded Pensions (hereinafter – the contested norm) is incompatible with Article 1 and Article 109 of the Satversme.

The Applicant notes that several fundamental principles of law follow from Article 1 of the Satversme: the principle of legal certainty, the principle of social state and the principle of social solidarity. The legislator has infringed

upon these principles by adopting the contested norm.

The social insurance relations, established on the basis of law, arise simultaneously with establishing labour relations. The employee makes the social insurance contributions with the employer's mediation, i.e., the employer calculates and makes social insurance contributions into the special social insurance budget (hereinafter also – the special budget), paying both the employer's and the employee's share of the social insurance contributions. Moreover, the fact that social insurance contributions are a tax should be taken into consideration.

The Applicant holds that the rights of persons subject to social insurance may not be linked with the fact whether another person – the employer – has or has not duly fulfilled his obligations set out in law. It is the obligation of the State, not that of the employee, to ensure that the employer makes social insurance contributions.

The person has the right to rely that all state institutions will abide by laws, i.e., the state institutions will ensure collection of social insurance contributions. The State Revenue Service, as the administrator of this tax, has sufficiently broad mandate to control paying of taxes, make collections on a non-contestation basis, submit claims to court, apply administrative sanctions. The Applicant holds that the legislator, in adopting the contested norm, had *a priori* allowed a possibility that the employer could breach the obligation to pay taxes.

Assessing the contested norm from the perspective of Article 109 of the Satversme, it should be taken into consideration that Latvia's pensions system is founded upon the principle of insurance, the social insurance contributions that are made form the pension capital of every person. Thus, it is contended that the contested norm deprives a concrete group of persons of the right to social security. The right to social security has been violated also by the State amending the legal regulation, which specifies fundamental rights set out in Article 109 of the Satversme, without legitimate aim.

3. The institution, which issued the contested act – **the Saeima** – does not uphold the Applicant's opinion and holds that the contested norm complies with Article 1 and Article 109 of the Satversme.

It follows from the principle contained by the contested norm that the amount of a person's pension depends upon the social insurance contributions,

which have been actually made. The social insurance contributions made for the State old-age pension create the persons pension capital, which is taken into consideration upon granting old-age pension. Since the contested norm is connected also with the regulation included in Section 5(4) of the Law “On State Social Insurance”, the Saeima in its written reply refers to the regulation of the law “On State Social Insurance” and arguments expressed in the Constitutional Court Case No. 2011-03-01.

The Saeima also points to the fact that the Cabinet of Ministers has analysed in the annotation to the law “Amendments to the Law on Funded Pensions” and to the law linked with this draft law “Amendments to the law “On the State Social Insurance”” the compliance of the restriction set out by the contested norm with the Satversme and has provided substantiation for the necessity of the contested norm.

The contested norm allows ensuring additional financial resources for covering the deficit in the social budget in 2011 and by facilitating the operation of the social insurance system, in order to guarantee in the long-term provision of full-fledged state social insurance services to persons. In connection with this it should be taken into account that at the end of 2011, according to the revenue and expenditure estimates for 2011, the financial reserves of the special budget will decrease till approximately 400 million lats. Thus, balancing the expenditure and revenues of this budget was necessary.

Pursuant with legal acts the social insurance contributions to the funded pensions scheme turn into the pension capital of the participants of the funded pension scheme, which is not included into the special budget revenue. Pursuant to Section 5 of the Law on Funded Pensions the accrued pension capital of each participant of the funded pension scheme is calculated and registered in the account of the participant in the funded pensions schemes. By providing that in pension insurance only the actually made social insurance contributions are taken into account, the amounts transferred into the 2nd level of pensions and the special budget expenditure would decrease (in 2011 – by 4.5 million lats, in 2012 – by 6.9 million lats, but in 2013 – by 16.6 million lats).

Thus, the restriction that the contested norms contain has a legitimate aim, i.e. to safeguard not only the interests of the special budget, but also the constitutional values referred to in Article 116 of the Satversme – the rights of other people, considering the obligation of State to ensure also in the future

payment of State pensions, as well as to provide other services granted in the framework of social security system.

The Saeima holds that the contested norm does not collide with persons' constitutional duty to pay taxes. On the contrary – it ensures better awareness of this obligation and legal consciousness in general. Simultaneously, the Saeima draws attention to the fact that the State has not released itself from responsibility, but is actively involved in preventing ungrounded decreasing of the level of employees' social protection by employer's disregard for regulatory enactments.

The Saeima asks to recognise Section 4(1) of the Law on Funded Pensions as being compatible with Article 1 and Article 109 of the Satversme.

The Constitutional Court Establishes

4. The Applicant asks the Constitutional Court to assess the compliance of the contested norm with the principle of legal certainty, which follows from Article 1 of the Satversme. Likewise, the Applicant asks to assess the compliance of the contested norm with the principle of socially responsible state, which follows from the totality of social rights guaranteed by the Satversme, as well as the rights to social security enshrined in Article 109 of the Satversme.

The contested norm envisages that the contributions into the scheme of funded pensions are part of the actually made contributions into the state pension insurance. Consequently, the pension capital is recorded and accrued, on the basis of the actually made social insurance contributions, i.e., in accordance with the actual procedure for making social insurance contributions.

The Constitutional Court has already assessed the compliance of the procedure for actual social insurance contributions with the Satversme. The Judgement of the Constitutional Court in Case No. 2011-03-01 concluded: "The legislator, introducing the procedure for actual social insurance contributions, has complied with the principles that follow from the Satversme and has acted within the limits of its discretion" (*Judgement of 20 December 2011 by the Constitutional Court in Case No. 2011-03-01, Para 24*). Thus, the conclusions made in the Judgement in Case No. 2011-03-01 on the procedure of actual social

insurance contributions are equally applicable to the regulation included in the contested norm.

5. Article 109 of the Satversme provides: “Everyone has the right to social security in old age, for work disability, for unemployment and in other cases as provided by law.”

The special nature of social rights defines the limits of the judicial control in this field. The criteria for evaluating the compatibility of a legal norm with the fundamental rights to social security may differ, depending upon whether the concrete norm restricts the rights granted to a person or defines fulfilling the positive duty of the state.

Article 109 of the Satversme does not regulate rules on pension system (*see, for example, Judgement of 25 February 2002 by the Constitutional Court in Case No. 2001-11-0106, Para 1 of the Findings*). Thus, the principles for establishing and operating the pensions system is an issue to be resolved through legislation, i.e., the legislator has the right to specify the content of social rights in laws.

The legislator, by creating the procedure for actual social insurance contributions, has not restricted a person’s fundamental rights to social security in old age, as the right to receive pension in the amount that the person has co-participated in accruing the pensions capital, remains, irrespectively of the procedure for recording the social insurance contributions made and of the level of the pensions system, to which these have been made. Therefore the contested norm cannot be considered as restricting the right to social security. Neither does the contested norm affects the positive obligation of the state to establish and to maintain a system, aimed at social and economic protection of persons, who have reached the retirement age. In the case under review the right to social security on at least minimum level is not affected.

The Constitutional Court has already noted that Article 109 of the Satversme does not prohibit the legislator from altering the established system of social security, i.e., the legislator may select another solution for dealing with social problems (*see: Judgement of 21 April 2010 by the Constitutional Court in Case No. 2009-86-01, Para 10*).

The political dimension of the legislator’s decisions regarding the implementation of social rights is important, i.e., decisions in this field are guided not so much by legal as by political considerations (*see: Judgement of 25*

February 2002 by the Constitutional Court in Case No. 2001-11-0106, Para 1 of the Findings, and Judgement of 8 November 2006 in Case No. 2006-04-01, Para 16).

However, the Satversme imposes restrictions also political decisions, therefore the scope of legislator's discretion in adopting decisions in the field of social rights must comply with the norms and principles of the Satversme. Therefore, within the framework of the case under review it must be verified, whether:

1) the legislator, in exercising its discretion, has acted lawfully, i.e., in compliance with the norms and principles of the Satversme, and whether the regulation on the operation of pensions system was amended with sufficient justification, i.e., whether the concrete regulation is aimed at realising interests important for the society and protecting constitutionally significant values;

2) whether the principle of legal certainty and the principle of socially responsible state have been complied with.

6. The recognition has been enshrined in the case law of the Constitutional Court that in assessing the compliance of legal norms with those principles that follow from Article 1 of the Satversme, the fact that the manifestations of these principles in different fields of law may differ must be taken into consideration (*see, for example, Judgement of 8 November 2006 by the Constitutional Court in Case No. 2006-04-01, Para 15.2 and Para 15.3, and Judgement of 21 December 2009 in Case No. 2009-43-01, Para 21*).

If the compliance of a legal norm adopted in a field of social law with the principles that follow both from Article 1 and Article 109 of the Satversme is simultaneously contested, then usually the compliance with Article 1 of the Satversme is examined in interconnection with Article 109 of the Satversme (*see, for example, Judgement of 1 December 2010 by the Constitutional Court in Case No. 2010-21-01, Para 13; Judgement of 10 January 2011 in Case No. 2010-18-01, Para 9, and Judgement of 18 February 2011 in Case No. 2010-29-01, Para 17*).

Thus, the compliance of the contested norm with the principle of legal certainty and the principle of socially responsible state must be examined in interconnection with Article 109 of the Satversme.

7. The funded pensions scheme is part of the pensions system established in Latvia, which gives to a person the possibility to accrue additional pension capital, without increasing the total amount of contributions for the old-age pensions, investing part of the social insurance contributions into financial instruments.

The three levels of the pension system are elements in a united system, which supplement and, accordingly, also influence one another. Adequate revenue is ensured within the framework of the system, without placing excessive burden upon the future generations, at the same time ensuring justice and solidarity, as well as the possibility to respond to the changing needs of individuals and society (*see: Judgement of 21 December 2009 by the Constitutional Court in Case No. 2009-43-01, Para 24*).

The basis of the pension system established in Latvia is that the social insurance contributions are a person's long-term investment, which guarantees the social security in the future. Moreover, the pensions system is characterised by the person's co-participation throughout the whole period of employment. Thus, a person may exercise the rights set out in Article 109 of the Satversme to a full extent, only if he or she has co-participated in the pension system. In such a case the amount of state old-age pensions is proportional to the social insurance contributions made.

Since funded pension plans without guaranteed rates of return are offered in Latvia, this level of pensions system does not guarantee to persons the right to concrete increase of the state old-age pension in the future. I.e., the profitability of the funded pension scheme directly depends upon the trends in the investment fund market. Fluctuations in the local and global investment fund markets directly impact the amount of pension that can be expected in the future. The participants in the pension plan themselves assume the risks linked with the profitability of the pension plan, by selecting the manager of the pension scheme (*see: Judgement of 1 December 2010 by the Constitutional Court in Case No. 2010-21-01, Para 18*).

Thus, the pension system as a whole and especially the funded pensions scheme ensures that the amount of a person's pension will be fair – proportional to the social insurance contributions made – and dependent upon the person's participation in the creation of the pension capital.

8. To assess, whether the legislator, by changing the operational rules of the pensions systems, has acted lawfully, the Constitutional Court must verify, whether the legislator has acted within the framework of the parliamentary procedure, i.e., whether the contested norm can be recognized as a law adopted in proper procedure, and whether the legislator, in regulating social rights, has abided by the general principles of law, inter alia, the basic operational principles of the pension system.

The Constitutional Court in its Judgement in Case No. 2011-03-01, recognising that contested norms in the case were adopted in compliance with the Satversme, already drew the attention of the Saeima to the fact that it was not admissible to regulate issues, which do not pertain to the fiscal year, within the framework of the package of state budget law. Moreover, since the minutes of the committee meeting do not reflect the assessment of significant arguments, it is impossible to gain an insight into the procedure of the sitting of the committee and the decisions (*see: Judgement of 20 December 2011 by the Constitutional Court in Case No. 2011-03-01, Para 18*). The Saeima in its reply has not noted and it does not follow from the case materials that the Saeima had acted differently as regards the adoption of the contested norm, i.e., had considered, whether this law should be included in the package of the state budget law. The minutes of the meeting of the responsible committee of the Saeima – the Budget and Finance (Taxation) Committee – do not reflect the arguments, which served as the ground for adopting the contested norm (*see: Case Materials, pp. 41 – 51*). However, the Constitutional Court in its Judgement in Case No. 2011-03-01 concluded that the contested norms were adopted and promulgated in proper procedure.

Thus, it is not necessary to repeat the assessment of the procedure for adopting the contested norm in the framework of this case.

9. The Saeima notes that the contested norm has two interconnected aims – to balance the special budget revenue and expenditure and to realise the right of other persons to social security, guaranteeing realisation of this right also in the future.

The Constitutional Court has already acknowledged that the aim to balance the revenue and expenditure parts of the special budget for state pensions as legally significant consideration in the field of social rights. The

balancing of the special social insurance budget must be recognised as the foundation for guaranteeing the sustainability of this budget, therefore it is important to avoid creating deficit in the special budget, as well as to ensure that paying of pensions is possible also in the future, when the demographic situation, perhaps, will be different (*see: Judgement of 11 November 2005 by the Constitutional Court in Case No. 2005-08-01, Para 8*).

The operation of the funded pension scheme is based upon long-term estimates of demographic and economic indicators. Already at the time when the concept of funded pension scheme was elaborated it was assumed that it might be necessary to adjust the initial economic and demographic forecasts and simultaneously amend the operational conditions of the scheme (*see: Case Materials, pp. 52 – 62*).

The European Commission has concluded that the fast aging of society could affect also the funded pension scheme. The economic growth rate decreases in an aging society, which means that also the amount of revenue will decrease, and this decrease might affect also the prices of financial assets. The possible decrease in the return rates of the pension fund investments might cause increasing of contributions, decreasing the pension benefits, faster flow of capital to emerging markets or assuming increased risks. The implementation of solutions aimed at ensuring sustainability of the pension system has increased each individual's responsibility for the operational outcomes of the pension system and it will continue to increase in the future. [*see: European Commission Green Paper – towards adequate, sustainable and safe European pension systems, SEC(2010)830, Brussels, 7 July, 2010, pp. 4–5*].

If the employer has not actually made the social insurance contributions for the employee and if the employee is registered in the funded pensions scheme, then, in order to ensure registering into the state funded pensions scheme the real sum of money and transfer to the asset managers, the resources of the first pension system level are used. Consequently the resources of the special budget decrease and the financial deficit of this budget increases.

The information collected by the State Social Insurance Agency (hereinafter – SSIA) shows that in 2010 the amount of social insurance contributions made into the funded pensions scheme was 66.4 million lats (*see: SSIA Report in the Operations of the State Funded Pension Scheme in 2010 <http://www.vsaa.lv/lv/pakalpojumi/stradajosajiem/2-pensiju-limenis/> parskati-*

par-valsts-fondeto-pensiju-shemas-darbibu, accessed on 16 January 2012). The Ministry of Finance in its turn has noted: the implementation of the transition to the registration and accrual of the pension capital, by taking into account the actually made social insurance contributions into the second level of pensions, achieves gradual balancing of the special budget revenue and expenditure in 2011 and in successive years, thus decreasing the financial deficit of the special budget (*see: Case Materials*, pp. 63 – 67).

The Constitutional Court has no grounds to doubt that the contested norm has decreased the threat to the pension system caused by the economic crisis and the demographic situation.

The contested norm is aimed at ensuring sustainability of the pensions system, balancing the revenue and expenditure of the special budget, thus also at safeguarding public well fare and the rights of other persons.

The contested norm has been adopted for the sake of important public interests and the protection of constitutional values.

10. The application contends that the contested norm is incompatible with the principle of legal certainty, which follows from Article 1 of the Satversme. The Applicant notes that the implementation of the new regulation significantly affects an individual's right to social security after reaching the retirement age. By not setting a period of transition for implementing the new regulation and by revoking the declared procedure for making social insurance contributions, the principle of legal certainty, enshrined in Article 1 of the Satversme, is infringed.

The principle of legal certainty means that a person can be certain that he or she will not be deprived of the rights and lawful interests, which he or she has acquired, at a later stage. This principle is founded upon a person's reliance upon lawful and consistent actions of the State. Its main objective is to protect a person's interests in those cases when amendments to legal regulation cause or might cause deterioration of the legal status of private persons (*see: Judgement of 8 November 2006 by the Constitutional Court in Case No.2006-04-01, Para 21*). However, the principle of legal certainty does not exclude the possibility for the State to amend the existing legal regulation (*see: Judgement of 1 December 2010 by the Constitutional Court in Case No. 2010-21-01, Para 19*). The principle of legal certainty provides, *inter alia*, that the rights acquired by a person cannot exist for an unlimited period of time, i.e., this principle does not

give grounds to believe that the once established legal situation will never change (*see: Judgement of 25 October 2004 by the Constitutional Court in Case No. 2004-03-01, Para 9.3*).

The contested norm was adopted on 20 December 2010 and came into force on 1 January 2011. The procedure for making actual social insurance contributions was applied to the social insurance contributions to be made in the future. The contested norm does not affect those social insurance contributions, which were made in accordance with the procedure of declared social insurance contributions; neither does it establish new obligations for a private person. Consequently, the legislator in this case did not have to establish a transitional period for the persons to adjust to the new procedure.

The contested norm does not affect the principle of legal certainty, thus, it is not necessary to assess its compliance with this principle.

11. To assess the compliance of the contested norm with the principle of a socially responsible state, the criterion, whether the solution chosen by the legislator is socially responsible, is applied. A solution, as the result of which the lawful interests of individual persons are aligned with the interests of the whole society, is a socially responsible solution. Under such conditions a socially responsible solution can be based upon providing to a person, simultaneously with amendments to legal acts, the possibility to exercise those rights that the state once granted, in accordance with the financial possibilities of the State (*see: Judgement of 15 March 2010 by the Constitutional Court in Case No. 2009-44-01, Para 22*).

The Constitutional Court already established that the procedure for making actual social insurance contributions complies with the principles that follow from the *Satversme* and ensures sustainability of the pension system, since the future generations are entitled to pensions in accordance with the actual social insurance contributions made (*see: Judgement of 20 December 2011 by the Constitutional Court in Case No. 2011-03-01, Para 24*).

The contested norm under review in this case does not envisage general change of the state policy vis-à-vis the operation of the funded pension scheme, but changes the procedure for registering resources to be paid into it. Moreover, the contested norm does not revoke the employer's constitutional obligation to

make the social insurance contributions as stipulated by law, neither does it release the legislator from the constitutional obligation to set up a mechanism that would allow the executive power to collect the social insurance contributions duly.

Thus, a person has the right to request the employer to make and the State to collect the social insurance contributions.

Thus, a person has the right to demand the employer to make the social insurance contributions and the State to collect the contributions duly.

Simultaneously a person has been ensured effective possibility to receive information, whether the employer has duly made the social insurance contributions. I.e., the section “investment plans” of the home page <http://www.manapensija.lv/> every day publishes information about the net asset values of investment plans, the number of participants of the funded pensions scheme and the return of investments in various periods. A participant of the funded pension scheme can receive information on his or her individual account at any SSIA branch upon presenting an identity document. Likewise, a member of the SSIA funded pensions scheme is ensured the possibility to view his or her annual account statements digitally, reports on the change of the asset manager of the funded pensions scheme and the investment plan, information on joining the funded pension scheme to those participants, who have applied at the Internet Bank maintained by the pensions manager (*see: Report prepared by SSIA on the operation of the State funded pensions scheme in the 1st half of 2011: <http://www.vsaa.lv/lv/pakalpojumi/stradajosajiem/2-pensiju-limenis/parskati-par-valsts-fondeto-pensiju-shemas-darbibu>, accessed on 16 January 2012*).

By introducing the procedure for making actual social insurance contributions the legislator has complied with the principle of a socially responsible state and introduced measures for stabilising the pensions system, as well as established an appropriate mechanism for implementing this procedure.

Thus, Section 4 (1) of the Law on Funded Pensions complies with Article 1 and Article 109 of the Satversme.

The Substantive Part

Pursuant to Sections 30 – 32 of the Constitutional Court Law, the Constitutional Court

h o l d s :

to recognise Section 4(1) of the Law on State Funded Pensions as compatible with Article 1 and Article 109 of the Satversme.

The Judgement is final is not subject to appeal.

The Judgement comes into force as of the day of its publishing.

The Presiding Judge

G. Kūtris