THE CONSTITUTIONAL COURT
OF THE REPUBLIC OF LATVIA

J U D G E M E N T

On Behalf of the Republic of Latvia

Riga, 19 December 2011

Case No. 2011-03-01

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

having regard to an application of twenty members of the Saeima [*Parliament*] – Mr Andrejs Klementjevs, Mr Jānis Urbanovičs, Mr Valērijs Agešins, Mr Ivans Ribakovs, Mr Sergejs Mirskis, Mr Boriss Cilevičs, Mr Nikolajs Kabanovs, Mr Sergejs Fjodorovs, Mr Aleksejs Burunovs, Mr Dmitrijs Rodionovs, Mr Aleksandrs Jakimovs, Mr Jānis Ādamsons, Mr Ņikita Ņikiforovs, Mr Valērijs Kravcovs, Mr Aleksejs Holostovs, Mr Aleksandrs Sakovskis, Mr Jānis Tutins, Mr Raimonds Rubiks, Mr Igors Zujevs and Mr Valentīns Grigorjevs (hereinafter – the Applicants),

with participation of Mr Eduards Ikvilds, a sworn advocate representing the Applicants,

with participation of Mr Gunārs Kusiņš representing the Saeima of the Republic of Latvia, the institution that issued the contested act,

with participation of a court hearing secretary Mr Arnis Žugans,

according to Article 85 of the Satversme [*Constitution*] of the Republic of Latvia, Article 16 1st indent, Article 17 (1) 3rd indent of the Constitutional Court Law,

in Riga, on 15 and 19 November 2011 in an open court hearing examined the case

"On Compliance of Section 5 (4) and Section 21 (2.[1]) of the Law "On State Social Insurance" with Article 1 and Article 109 of the Satversme of the Republic of Latvia".

The Facts

1. On 1 October 1997, the Saeima adopted the Law "On State Social Insurance" (hereinafter – the Social Insurance Law). Section 5 (4) thereof provided that a person is socially insured and he or she must make mandatory contributions (regarding thereof) from the day when such person has acquired the status referred to in Paragraph one of this Section, except for the status of a self-employed person. Para 1 of Transitional Provisions of the Social Insurance Law provided that Section 5, Paragraph four of this Law (as of 20 June 2001) shall be applied from 1 January 2002. From 1 January 1998 to 1 January 2002, a socially insured person was a person who has made mandatory contributions. This condition does not apply to persons who are subject to social insurance in respect to accidents at work. On 25 November 1999, the Saeima amended the Social Insurance Law by prolonging the period established in Para 1 of Transitional Provisions of the Law up to 1 January 2004.

On 13 March 2001, the Constitutional Court adopted a judgment in the case No. 2000-08-0109 "On Compliance of Para 1 of Transitional Provisions of the Law "On Compliance of Item 1 of the Transitional Provisions of the Law "On Social Insurance" with Articles 1 and 109 of the Satversme (Constitution) of the Republic of Latvia and Articles 9 and 11 (the first Part) of the December 16, 1966 International Pact on Economic, Social and Cultural Rights" (hereinafter – the Judgment in the Case No. 2000-08-0109) where a norm that confers a person the

right to social insurance services only in case if mandatory state social insurance contributions (hereinafter – the social insurance contributions) have been made was recognized as non-compliant with Article 109 of the Satversme of the Republic of Latvia (hereinafter – the Satversme).

On 20 December 2010, the Saeima adopted the Law "Amendments to the Law "On State Social Insurance"" that came into force on 1 January 2011. This law established the following wording of Section 5 (4) of the Social Insurance Law:

A person is socially insured in respect to accidents at work, unemployment, invalidity insurance, maternity and sickness insurance, as well as parents' insurance, and he or she must make mandatory contributions (regarding thereof) from the day when such person has acquired the status referred to in Paragraph one of this Section, except for the status of a self-employed person. A person shall be socially insured in respect to pension insurance if mandatory contributions have been actually paid."

Meanwhile, Section 21 of the Social Insurance Law was supplemented with Indent $2.^1$ with the following wording:

"In case if the employer has failed to made stipulated social insurance contributions, the person regarding whom the employer had the duty to make contributions and who has reached the age permitting receiving old age pension can make social insurance contributions for pension insurance. The Cabinet of Ministers shall regulate provisions, term and procedure for making social insurance contributions for pension insurance."

These amendments to the Social Insurance Law change the kind of pension insurance by establishing that a person is socially insured in respect to pension insurance only in case if social insurance contributions have been made regarding him or her in actual fact. Consequently, the amount of State old age pension depends on factual social insurance contributions.

2. The Applicants, **twenty members of the 10th Saeima** hold that Section 5 (4) and Section 21 ($2.^1$) of the Social Insurance Law (hereinafter –

the Contested Norms) fail to comply with Article 1 and Article 109 of the Satversme.

The Applicants indicate that several legal principles follow from Article 1 of the Satversme: the principle of legitimate expectations, that of a social State and that of social solidarity. When adopting the Contested Norms that establish the right of persons to social security in the old age only in case if social insurance contributions have been made in actual fact, the legislator has breached these principles.

Social insurance relationships are formed on the basis of law simultaneously with initiation of labour relations. An employee makes social insurance contributions by mediation of his or her employer, namely, the employer calculates and makes respective contributions into the special social insurance budget (hereinafter also referred to as – special budget), which comprises both, the part social insurance contribution of the employer and that of the employee. Moreover, it should be taken into account that social insurance contribution is a tax.

If the employer has failed to make the stipulated social insurance contributions to ensure pension insurance, then the person regarding whom the employee had the respective commitment suffers negative consequences after having received the age that gives the right to receive State old age pension, namely, the amount of social security is reduced. According to the Applicants, the rights of persons subject to social insurance cannot be linked with the fact whether another person, namely the employer has or has not duly fulfilled stipulated duties. This is the State rather than the employee who has the duty to ensure that the employee would make social insurance contributions. According to the Applicant, in a democratic State it should actually be presumed that persons would exercise their stipulated rights and fulfil their duties in good faith.

A person shall have the right to trust into the fact that public institutions would observe laws, namely, that public institutions would ensure collection of social insurance contributions. The State Revenue Service (hereinafter – the SRS) [*Valsts ieņēmumu dienests*] being the administrator of the particular tax has a broad authority to control correctness of tax collection, perform tax recovery on a no contestation basis, apply to the court, or execute administrative sanctions. The

Applicants hold that, when adopting the Contested Norms, the legislator has already anticipated that the employer could avoid fulfilling the duty of paying taxes. At the Court hearing, the representative of the Applicants indicated the following: the State has admitted its incapacity in combatting illegal employment rather than rendered measures of tax collection control more effective.

When assessing the Contested Norms in the light of Article 109 of the Satversme, it should be taken into consideration that the Latvian pension system is based on the insurance principle, namely, social insurance contributions form the pension capital of each person. Consequently, the Contested Norms deprive certain group of persons of the right to social security.

At the court hearing, the representative of the Applicants emphasized the following: when adopting the Contested Norms, Article 32 (2) of the Constitutional Court Law has been breached. The particular article provides that a Constitutional Court judgement and the interpretation of the relevant legal norm provided therein shall be obligatory for all State and local government institutions (also courts) and officials, as well as natural and legal persons. By adopting the Contested Norms, the legislator has failed to observe the ruling of the Judgment in the case No. 2000-08-0109.

It can be concluded form the course of the 15 December 2010 Saeima Budget and Finance (Taxation) Committee [*Saeimas Budžeta un finanšu (nodokļu) komisija*] meeting that the Contested Norms have been adopted in haste; therefore no possible consequences have been thought over. When adopting the Contested Norms, the legislator was considering short-term tasks of the social security system. By referring to case-law of the Constitutional Court, the Applicants emphasizes that the social protection system may not be used as an instrument for reaching of short-term objectives. The legislator has to consider impact of each decision on sustainability of the pension system.

3. The Saeima, the institution that adopted the contested act does not agree with the opinion of the Applicants and holds that the Contested Norms do comply with Article 1 and Article 109 of the Satversme.

The Saeima draws attention to what the Constitutional Court has reiterated, namely, that the right to social security established in Article 109 of the Satversme is not absolute and the legislator can impose certain restrictions thereon.

Social insurance services (pensions, benefits and reimbursements) depend on the amount of income that is subject to social insurance contributions. Therefore persons are indirectly interested into declaring all income, making regular social insurance contributions, as well as remaining an active labour force as long as possible.

At the court hearing, the Saeima representative also indicated that one of the fundamental postulates of the market economy of Latvia states that an economically unsuccessful enterprise may become insolvent and go bankrupt due to certain internal or external circumstances. This is the philosophy of market economy. Consequently, a person that works in the private sector has to be aware that insolvency is not excluded. This is an inevitable consequence of economic model that the State can mitigate, though not eliminate. The State is not committed to fully compensate high salary promised and declared by an employee and the consequential and ungrounded social insurance contributions.

The Contested Norms permit ensuring additional financial means in the social budget to cover deficit in 2011 and facilitates functioning of the social insurance system in order to guarantee sustainable provision of State social insurance services to persons. Due to this fact, it should be taken into account that, based on trends of incomes and expenses in 2011, at the end of 2010 financial reserves of the special budget diminished by about 400 million lats. Consequently, it was necessary to balance incomes and expenses of the particular budget.

The restriction included into the Contested Norms does have a legitimate aim, namely, to protect not only interests of the special budget but also the constitutional values referred to in Article 116 of the Satversme, namely, rights of other persons, taking into account the duty of the State to ensure disbursement of pensions in the future and provision of other services in the frameworks of the social insurance system.

The Saeima indicates that, since there is a great difference between declared social contributions and factual ones, employees regarding whom the contributions are made undertake a disproportionally heavy burden regarding disbursing of social insurance contributions, which threatens effective implementation of the solidarity principle. The Contested Norms reduce this burden in respect to employees and help ensuring as fair balance between the contradictory interests of different members of the society as possible.

The Saeima holds that, by binding the Contested Norms with long-term contribution – State old age pensions, this causes no material infringement of the rights of employees, especially due to the fact that the second level of the pension system (the mandatory State funded pension scheme) is based on the principle of individual contributions. Adoption of the Contested Norms shall be regarded as a socially responsible solution, the aim of which is to ensure sustainability of the social budget, as well as to protect the right of persons to social security. It was on purpose that the legislator has related legal consequences of the Contested Norms only to one of the services of social insurance, namely, the State old age pension, which usually is social security service that a person benefits from at a particular time of life. The Contested Norms do not apply to those kinds of social security that might become necessary to a person at any time whenever unforeseen or urgent conditions occur. In this particular context, the legislator has observed the principles set out in the Judgment in the case No. 2000-08-0109,

The Saeima holds that issues identified in the Judgment in the case No. 2000-08-0109 have been solved by adopting the 20 December 2001 Law "Law On Protection of Employees in Case of Insolvency of Employer" because situation when an employer fails to make contributions regarding an employee are mainly related with insolvency of the employer. According to the above mentioned law, the established fund protects the right of employees to salary and the fact that social contributions would be made regarding them.

The Contested Norms shall be regarded as one of measures that are aimed at elimination of shadow economy. The Saeima shares the opinion of the Applicants that monitoring of fulfilment of employers' duties and combatting of shadow

economy is first of all the task of the State. However, taking of such important measures without involvement of the persons concerned and the entire society would not turn out to be effective and would imply great financial costs. The Saeima holds that it should be accepted that in certain cases the State would commit a person to participation when certain rights should be ensured. A person is involved in exercise of his or her right to social security in order to monitor whether the employer makes social insurance contributions in actual fact. In such a case, a person can verify information related to oneself and draw attention of the employer and public institutions to particular facts in a more effective manner if compared to public institutions when verifying the particular information on all employers and employees of the State.

It is also indicated that the State shall not be responsible for persons who have failed to pay attention to the fact how they or their employers fulfil their stipulated duties in front of the State and have trusted into the fact that in case of need the State would provide aid to them. Moreover, this would make questioning fairness of any such solution that would stimulate a person to agree to tax evasion or receipt of a part of the salary in an illegal way with the purpose to reduce taxes to be paid.

The Saeima holds that the Contested Norms do not contradict the constitutional duty of a person to pay taxes. Quite on contrary – they ensure a more profound understanding of one's duties and facilitate legal awareness in general.

Meanwhile, the Saeima draws attention to the fact that the State has not released itself from responsibility but, instead, has worked to prevent ungrounded reduction of social protection level of employees in case if employers fail to observe normative acts. Data provided by the SRS regarding the structure of tax debts as on 1 June 2011 shows that, when recovering delayed tax payments, different measures aimed at preservation of entrepreneurship are applied. The State can not be committed to collecting all taxes without assessing individual situation of certain tax payers and circumstances that have caused the default in front of the State.

When adopting the Contested Norms, the legislator has chosen the less advantageous solution for budget balancing if considered in short and long term. The Contested Norms have been elaborated after having thoroughly assessed alternatives and considering the fact how the Contested Norms would impact the right of persons to social security, as well as taking into account conclusions made by the Constitutional Court regarding observance of the principle of legitimate expectations under circumstances when the right to social security are being restricted.

4. A summoned person, **the Saeima Social and Labour Affairs Committee** [*Saeimas Sociālo un darba lietu komisija*] informs the Constitutional Court that on 7 December 2010 the Cabinet of Ministers submitted a draft law to the Saeima in the framework of the State budget portfolio of laws, it containing the Contested Norms. At the **Saeima Social and Labour Affairs Committee meeting, Ms Aija Barča, Head of the 10th Saeima Social and Labour Affairs Committee** indicated that the legal regulatory framework included into the Contested Norm could be duly assessed in three readings pursuant to requirements of the Saeima Rules of Order; however, the Contested Norms were included into the package of draft budget laws and was reviewed in two readings. However, this fact as such does not cause any infringement of norms of the Satversme.

It has been indicated in the annotation to the draft law that, on 17 November 2010, the Cabinet of Ministers adopted Order No. 674, the Conception on Stability of the Social Insurance System in the Long Term [*Koncepcija par sociālās apdrošināšanas sistēmas stabilitāti ilgtermiņā*] (hereinafter – the Conception). According to the Conception, it is planned to make transition to registration and accumulation of pension capital based on factual social insurance contributions in the first and the second level of the pension system as from 2011.

A structured economy revitalization policy serves as the basis for facilitating high quality development by means of such measures as active employment policy, vocational education, investments and innovation by thus ensuring creation of more and higher quality work places. In its turn, this would help stabilizing the existing

generation solidarity scheme. Therefore Latvia refused such pension system in 2000 that was based only on the solidarity principle. The State passed over to mixed systems, namely, such systems that are based on the generation solidarity scheme and pension funds.

The Saeima Social and Labour Affairs Committee indicated the following: if a person does not have the right to receive social insurance services, it still can benefit from social assistance services that are regulated by the Social Services and Social Assistance Law.

From 1998, the State Social Insurance Agency [*Valsts sociālās apdrošināšanas aģentūra*] (hereinafter – the SSIA) transmitted the duty of administration of social insurance contributions to the SRS that is henceforth responsible for collecting of social insurance contributions and recovery of debts. In the Saeima Social and Labour Affairs Committee meeting of 16 February 2011, the Committee reviewed the issue regarding recovery of debts of social insurance contributions and concluded that the procedure of collecting social insurance contribution is not effective enough and it is necessary to improve the proceedings of debt recovery.

At the court hearing, Ms A. Barča drew attention of the Constitutional Court to the fact that the procedure for making social insurance contributions elaborated by the Cabinet of Ministers was dilatory.

5. A summoned person, **Mr Jānis Reirs, an authorized representative of the Saeima Budget and Finance (Taxation) Committee and Head of the 10th Saeima Budget and Finance (Taxation) Committee** informed, at the court hearing, that the Saeima Budget and Finance (Taxation) Committee reviewed the Contested Norms in the frameworks of the package of draft budget laws. The Saeima Rules of Procedure provides that budgetary sets of law shall be reviewed on urgent basis in two readings. When reviewing the Contested Norms in the first reading, the Saeima Budget and Finance (Taxation) Committee had doubts regarding solutions included therein; therefore it asked to provide additional argumentation and suggestions from the competent ministry. At the meeting of 14 December 2010, the Saeima Budget and Finance (Taxation) Committee analysed

problems of the pension system and asked the Ministry of Welfare to prepare additional solutions for ensuring sustainability of the special budget. Solutions suggested by the Ministry of Welfare were reviewed in the 16 December 2010 meeting of the Saeima Budget and Finance (Taxation) Committee. Mr J. Reirs indicates that this has been an unprecedented case in the history of elaboration of the State budget because the Saeima Budget and Finance (Taxation) Committee worked several days with the particular draft law.

When examining the Contested Norms, members of the Saeima Budget and Finance (Taxation) Committee assessed its possible impact onto the pension system. They also organized discussions and heard representatives of the Ministry of Welfare and the Ministry of Finance, as well as took into consideration the opinion of the Saeima Legal Bureau [*Saeimas Juridiskais birojs*]. Finally the Saeima Budget and Finance (Taxation) Committee elaborated suggestion that provided that in certain circumstances this is the person himself or herself who shall have the right to make social contributions on his or her own part in case if the employer has failed to do so, as well as the legal regulatory framework included into the Contested Norms shall be reassessed on regular basis, namely, the Cabinet of Ministers shall monitor implementation of the Contested Norms and inform the Saeima on their efficiency.

6. A summoned person, **the Ministry of Welfare** indicates that the principle of functioning of the special budget is self-financing; namely, normative acts establish a close ling between social insurance contributions and social insurance services.

The Contested Norms have been adopted in the period when expenses of the special budget increased rapidly and unemployment rate increased. It should also be noted that since 2009 the social insurance system's balance is negative, which is compensated by means of savings of previous years. Moreover, aging of the society constitutes a material threat to stability of the State social insurance system. If the principle of declared social insurance contributions would still applied to State old age pensions, then the financial reserve accumulated in the special budget would

decrease rapidly, which would threaten sustainability of the pension system. Adoption of the Contested Norms is an indispensable action and their aims could not be reached by other means that would restrict the rights of persons at a lesser extent.

To reduce deficit of the special budget, it was possible to choose alternative solutions. When elaborating changes to be introduced into the domain of social security, several alternative solutions were considered. As one of the alternative solutions, it was suggested to increase the social insurance contribution rate, to borrow resources from the Treasury, apply the principle of factual contributions to all kinds of social insurance, or reduction of benefits and pensions. However, the Ministry of Welfare indicates: in order to save financial resources, it would be necessary to considerably reduce the amount of pensions and benefits. The above mentioned alternatives are less advantageous to the rights and interests of persons.

The Ministry of Welfare indicates that normative acts give the possibility to employees to control whether and how the employer makes social insurance contributions regarding him or her, as well as to make social insurance contributions on his or her own in the case of need. Moreover, if compared to the period when the Judgment in the case No. 2000-08-0109 was adopted, an important additional mechanism for protection of rights and interests of employees has been introduced into normative acts.

According to the Ministry of Welfare, failure to make social insurance contributions during a certain period of time does not have any substantial impact on the amount of the State old age pension because the period from ceasing making the contributions up to the date of receipt of the old age pension is long enough for the State to be able to ensure recovery of social insurance contributions by means of compulsory mechanisms or other means, or to compensate them by making respective disbursement form the Employee Claims Guarantee Fund [*Darbinieku prasījumu garantiju fonds*]. The amount of the State old age pension may diminish in case if, pursuant to the restrictions established in the Law "On Protection of Employees in Case of Insolvency of Employer", the debt of social insurance

contributions is compensated from the Employee Claims Guarantee Fund at full amount. The Ministry of Welfare emphasizes that a person shall have the right to make social insurance contributions on voluntary basis.

The principle of factual contributions can be applied to the State old age pension because the State old age pension as a social insurance service is subject to actual insurance principles, according to which the service is being ensured only in case if insurance bonus has been paid; however, these principles may not be applied to those kinds of State social insurance that a person may need at any time whenever unforeseen or urgent expenses occur.

The representative of the Ministry of Welfare also indicated that the State old age pension is, in fact, the only social insurance service that has never been subject to consolidation measures taking into account the fact that the judgment of the Constitutional Court had once annulled a legal norm that established cut of old age pension.

The Ministry of Welfare indicates that norms of the Law "On State Pensions" (hereinafter –Pensions Law) do not require linking pensions with the subsistence wage. Nonetheless, in the context of the Contested Norms, the right of persons to social security at the minimum amount is guaranteed pursuant to Para 34 of Transitional Provisions of the Pensions Law that establishes minimum amount of pensions that depend on the length of service of a person and the amount of the social security benefit.

The Ministry of Welfare holds that, in the context of the Contested Norms, the right to social security in the old age as established in Article 109 of the Satversme is conferred as on the moment when the person has reached the age of 62 years established in Section 11 (1) of the Pensions Law and its length of service is not less than 10 years.

The Ministry of Welfare informs that the SSIA has introduced an electronic service, in the frameworks of which a person can request and receive data from the information system regarding social insurance contributions made by his or her employer.

7. A summoned person, **the Ministry of Finance** informs: pursuant to monthly reviews of the Treasury, the amount of savings of the special budget as on 1 July 2011 was 299.8 million lats, which has reduced by 102.1 million lats if compared to the amount of savings as on 1 January 2011.

In 2013, it is planned to have income of 1205.1 million lats into the special budget, whilst expenses are estimated at the amount of 1400.2 million lats, which would lead to a negative balance of 195.1 million lats. Consequently, the special budget would not be balanced because the estimated exceed of expenses over income causes a situation when balance of the special budget would be used for covering of the deficit.

The Ministry of Finance indicates that, if compared to the method of formation of the State basic budget, which is disbursement of such resources that are proportional with incomes into the budget, different methods and indices are applied when planning incomes and expenses of the special budget. Income of the special budget is basically formed by social insurance contributions that are made by actual employed persons; therefore incomes of a current year depend on the number of employees and amount of salaries. However, when planning expenses form the special budget, it is necessary to take into account number of expected beneficiaries of social insurance services and amount of the services of the respective year.

Taking into account the trends of the special budget, estimates of incomes, expenses estimated for the following year and the demographic situation, the following can be concluded: if no consolidation measures would be taken, savings of the special budget would be used in the foreseeable future. Moreover, it should be noted that expenses of the special budget still exceed its incomes because during the period of economic growth, the amount of pensions and benefits increased along with the increase of wages, which was also the case regarding the number of beneficiaries.

The Ministry of Finance draws attention of the Constitutional Court to the fact that along with the general change of the social insurance principle, by introducing the principle of factual social insurance contributions in respect to State

pension insurance, the SRS has revised work organization priorities in order to ensure an effective tax collection.

8. A summoned person, **Ms Baiba Felsberga, an authorized representative of the** SSIA **and Head of the Pension Methodological Management Department** indicated at the court hearing that the Contested Norms have been applied as from 1 January 2011.

The SSIA and the SRS have concluded a collaboration agreement on provision of information, namely data on certain insured persons, including data on declared income and factual social insurance contributions. These data are exchanged three times a week.

In case if the SSIA receives a pension request and it is established that the employer has failed to make social insurance contributions regarding a particular person, then a person is informed thereon. In such a case, the person is suggested to make social insurance contributions by himself of herself. Exercising the right established in Section 21 ($2.^1$) of the Social Insurance Law, the person pays the social insurance contributions rate established in respect to pension insurance, which is 25.56 per cent. Failure to make social insurance contributions in a short period may considerably impact the amount of the pension.

9. A summoned person, **Ms Sanita Garance, an authorized representative of the SRS and Deputy Head of the Tax Administration** indicated at the court hearing that, like in the case with all other taxes, also in respect to social insurance contributions the SRS fulfils the control function and verifies whether all necessary payments are declared, calculated and made at a proper amount.

The Law "On Taxes and Fees" provides that collection of social insurance contributions and recovery of delayed contributions is the duty of the SRS. However, normative acts do not provide which of the taxes non-paid should be recovered first.

The International Monetary Fund has also drawn attention to the fact that the capacity of the SRS administration does not permit to fulfil an effective tax

collection, recovery and control. Taking into account this comment, in 2010 and 2011 certain capacity fields of the SRS have been strengthened, the domain of tax recovery and control included. As a result, the capacity of the SRS administration has been improved and social insurance contributions are settled in 91.2 per cent of cases.

The majority of all actions related to recovery of social insurance contributions performed by the SRS in 2010 have been of preventive nature. Consequently, entrepreneurs were given the possibility to solve their financial difficulties by exercising the right to ask extension of the term for payment of delayed tax payments, division of the term or permission to suspend payment of taxes and perform other measures established in normative acts aimed at preservation and restoration of business as provided in the Law "On Taxes and Fees".

10. A summoned person, **the Ombudsman of the Republic of Latvia** (hereinafter – the Ombudsman) indicates that the social insurance system, its principles of actual situation may change in the course of time. Therefore conclusions made in the previous judgment of the Constitutional Court may turn out not to be applicable to the effective legal regulatory framework and the situation in general. Consequently, It should be investigated whether the actual situation and the legal regulatory framework in respect to rights and duties of employees has considerably changed since adoption of the Judgment in the case No. 2000-08-0109.

The Ombudsman is of the following viewpoint: although certain norms have been amended since 2011, the social insurance system that was introduced on 1 January 1996 is still in force in the State. Principles of social insurance have not changed – certain groups of persons are subject to social insurance, including employees regarding whom social insurance contributions are made by their employers.

An employee can neither register his or her social insurance contributions at the State Revenue Service, nor make social insurance contributions by himself or

herself. According to the Ombudsman, the Contested Norms do restrict the right to social insurance in the old age guaranteed in Article 109 of the Satversme.

The Ombudsman does not share the opinion that a material additional mechanism for protection of rights and interests of employees has been introduced into normative acts since adoption of the Judgment in the case No. 2000-08-0109. In case of insolvency of the employer only normative acts confer the right of employees to social security, which is not the case in other situations.

The Ombudsman holds that possibilities of a person to monitor information on social insurance contributions made cannot serve as basis for reduction of the limits of responsibility of the state in the field of social insurance.

The Ombudsman considers the Contested Norms as measures to reduce shadow economy positively. Nonetheless, it holds that these measures have failed to achieve such result that would change the situation since adoption of the Judgment in the case No. 2000-08-0109.

The Ombudsman emphasizes that in a law-governed and democratic State, when elaborating certain normative regulatory framework, the legislator may not guide itself by the presumption that a person would abuse social insurance services and avoid fulfilling his or her constitutional duty to pay taxes. If the legislator potentially considers such possibility, it is committed to establish a proper mechanism to prevent it.

When assessing the Contested Norms in conjunction with the information provided in the annotation, the following can be concluded: the legislator holds that there are situation in the State when employers fail to make social insurance contributions. Consequently, the compulsory mechanism effective in the State is not effective enough to prevent all such cases.

The Ombudsman has no information at its disposal regarding the fact whether the legislator has made an objective and comprehensive assessment of impact of alternative mechanism on interests and rights of individuals. Transcripts of Saeima meetings do not show whether any alternatives have been considered. Moreover, the Ombudsman holds that the solution selected by the legislator is not the most lenient one for reaching of the legitimate aim.

Since the duty of the legislator was to observe the Judgment in the case No. 2000-08-0109, the Contested Norms shall be regarded as contradictory to the conclusions made in the above mentioned Judgment and therefore they may not be regarded as constitutional.

11. A summoned person, *Mg. mpa*. **Ms Maija Poršņova** indicates that the Latvian pension system is based on the principle of social insurance, while its milestone is provision of services pursuant to actual contributions made. The pension system can successfully function only in case if a certain balance exists between contributions and disbursements, and incomes of the pension system does not exceed its expenses.

Social insurance contributions are the only tax, the amount of which impacts direct disbursements, for instance, pensions. Taking into account the aforesaid, the following can be concluded: if a person trust into the pension system in the long term, he or she is interested in making social insurance contributions. Namely, the amount of social guarantees in case of occurrence of an insurance risk depends directly from social insurance contributions, and this aspect facilitates payment of the tax based on real incomes.

When establishing the effective pensions system, as a temporary solution it was established that the amount of pensions and benefits would depend on factual social insurance contributions rather than on contributions that should have been made. Such solution was selected for persons to be able to estimate, at what extent social insurance contributions actually made would impact the amount of pension or benefit to be received.

Ms M. Poršņova indicates that recently many countries of the world tend to base their social insurance systems on the principle of neoliberalism – every person is responsible for the amount of his or her social security amount. Due to change in structure of inhabitant age, the states tend to strengthen link between the amount of contributions into social insurance funds and disbursement from them. This is a common trend implemented in the pension system of Latvia.

If collection of social insurance contributions is not ensured at full extent, then the right to social insurance in the meaning of Article 109 of the Satversme are restricted not only in respect to persons regarding whom an employee has failed to make social insurance contributions but also to those persons regarding whom they have been made since funds of the special budget reduces in general disregarding the reduction of amount of disbursement from the special budget. The principle of social solidarity establishes the necessity to ensure disbursement of a pension or a benefit to a person regarding whom social insurance contributions have not been made into insurance funds. It must not be permitted that the State would disburse pensions and benefits at the amount, at which employees had to make social insurance contributions pursuant to law, though at which the State has failed to ensure collection of the contributions.

12. A summoned person – *Dr. oec*. **Mr Edgars Voļskis**, when assessing compliance of the Contested Norms with Article 109 of the Satversme, concludes that a person regarding whom social insurance contributions have not been made is, in fact, denied the right to receive social insurance in case of occurrence of a certain social risk because he or she has failed to obtain the status of a socially insured person. The Pensions Law provides that the right to receive the State old age pension shall be conferred to persons living in the territory of Latvia who were subject to the State mandatory pension insurance scheme, namely, regarding whom social insurance contributions have been made.

Mr E. Voļskis draws attention to the fact that the Contested Norms contradict the Section 9 (1) of the Pensions Law. According to the above mentioned norm, the amount of a State pension is dependent upon the length of period of insurance, in which shall be counted the months in which insurance contributions were made or needed to be made for the relevant type of social insurance. Consequently, it is possible to accumulate length of period of insurance even if an employee has had registered labour relations with an employer, though the employee has failed to make social insurance contributions regarding him or her. Consequently, this breaches the principle of justice of the social insurance system because a person who fails to make

social insurance contributions shall have the right to receive compensation in occurrence of risks established in normative acts.

Mr E. Voļskis holds that the legislator has not yet fulfilled its duty to ensure a dignified existence for individuals and social insurance at the minimum level. Pursuant to Para 34 of Transitional Provisions of the Pensions Law, the minimum amount of old age pension may not be less that the state social security benefit; moreover, when calculating the amount of the pension, a coefficient is applied based on the length of service of a person. It should be taken into account that the minimum social security amount in Latvia is considerably lower than the subsistence wage, which makes people live below the defined poverty threshold of Latvia, and it constitutes about 40 per cent of the average wage of the State. However, the terms "dignified existence of an individual" and "poverty threshold" are subjective and relative because different methods can be applied to calculate a particular measurement.

At the court hearing, Mr E.Voļskis explained that sustainability of the pension system is based on the principle of solidarity, that of justice and individual contribution. Moreover, participants of the pension system should undertake individual responsibility for an adequate participation in the particular system. According to Mr E. Voļskis, Section 5 (4) of the should be supported if considered in the context of structure of the pension system and endurance of sustainability because it functions as a preventive mechanism and facilitates participation of members of the society and their participation into the State social insurance system based on the principle of solidarity, as well as ensure functioning of the pension system in the long term in accordance with its fundamental principles.

At the court hearing, Mr E.Voļskis indicated the following: It has been concluded in the doctrine of economy that behaviour of an individual is of such character that it is not possible to ensure his or her participation in social insurance system on voluntary basis without mediation without adopting particular normative acts. Therefore, as to issues regarding the possibility of employees to make social insurance contributions on voluntary basis by abandoning the first and the second

pension system level, he concludes that such mechanism would never work due to economic behaviour of individuals.

The Findings

I

13. The Applicants ask the Constitutional Court to assess compliance of the Contested Norms with the principle of legitimate expectations that follows from Article 1 of the Satversme. Likewise, the Applicants request assessment of compliance of the Contested Norms with the principle of a socially responsible state that follows from the body of social rights guaranteed in the Satversme, as well as with the right to social security enshrined in Article 109 of the Satversme.

Although case participants apply the term "the principle of factual social insurance contributions" when characterizing the legal regulatory framework of the Contested Norms, the Constitutional Court holds that it would be correct to denote the legal regulatory framework as "procedure of making factual social insurance contributions" because the Contested Norms, in fact, determine the procedure for registering social insurance contributions.

The first sentence of Section 5 (4) of the Social Insurance Law provides that the procedure of declared social insurance contributions shall be applicable to insurance of accidents at work, insurance regarding unemployment, invalidity insurance, maternity and sickness insurance, as well as child care insurance. Namely, in the above mentioned cases of social risk a person shall be regarded as a socially insured one as of the date when he or she has obtained the status of a socially insured person. However, the second sentence of the same section provides that the procedure of factual social insurance contributions shall be applied to pension insurance. A person shall be insured regarding pension insurance if contributions have been made in actual fact.

The Constitutional Court has already concluded in its case-law: if the Contested Norm applies to a wide scope of different situations, the Constitutional Court should concretize the extent, to which it assesses the Contested Norm (*see: Judgment of 28 May 2009 by the Constitutional Court in the case No. 2008-47-01, Para 6*).

It follows from argumentation set forth in the application that in the present case there are doubts about the fact whether application of the procedure of factual social insurance contributions to pension insurance complies with legal norms of a higher legal force. The participants have provided legal argumentation only in respect to compliance of the second sentence of Section 5 (4) of the Social Insurance Law with Article 1 and Article 109 of the Satversme. Moreover, at the court hearing, the representative of the Applicants asked the Constitutional Court to assess compliance of the legal regulatory framework of the second sentence of Section 5 (4) of the Social Insurance Law with Article 1 and Article 109 of the Satversme.

Consequently, the Constitutional Court shall assess only compliance of the second sentence of Section 5 (4) of the Social Insurance Law with Article 1 and Article 109 of the Satversme.

13.1. Section 21 (2.^{1}) of the Social Insurance Law regulates issues related to the procedure of factual social insurance contributions, namely, the procedure, according to which social insurance contributions should be made in case of pension insurance in case if the employee has failed to do so. The above mentioned article also includes authorization to the Cabinet of Ministers to elaborate procedure, according to which a persons would make social insurance contributions for pension insurance.

It follows from the case materials and opinions expressed by the case participants and the summoned persons that, in the present matter, there is no dispute regarding the authorization granted by the legislator to the Cabinet of Ministers to elaborate respective provisions.

Consequently, the Constitutional Court shall assess compliance of Section 21 (2.^{1}) of the Social Insurance Law with Article 1 and Article 109 of

the Satversme insofar as it applies the legal regulatory framework included in the second sentence of Section 5 (4) of the Social Insurance Law.

13.2. It follows from the argumentation set out in the application that, in the frameworks of the present case, the Court should investigate the following claims regarding compliance of several legal regulatory frameworks with legal norms of a higher legal force. The following shall be assessed in the present case:

1) whether the procedure of factual social insurance contributions, namely, the fact that a person is deemed to be socially insured person regarding pension insurance only in case if social insurance contributions have been made regarding him or her in actual fact, complies with Article 1 and Article 109 of the Satversme;

2) whether the fact that the right of a person to social security is related to due fulfilment of stipulated duties of another person complies with Article 1 of the Satversme of the Republic of Latvia, namely, whether an effective implementation mechanism in respect to the procedure of factual social insurance contributions has been crated.

Exercise of rights of persons to social security is directly related to effective functioning of the social protection system; therefore the Constitutional Court shall first of all assess whether application of the procedure of factual social insurance contributions to pension insurance complies with legal norms of a higher legal force.

14. The Constitutional Court has already assessed a legal norm similar to the contested ones (*see: Judgment of 13 March 2001 by the Constitutional Court in the case No. 2000-08-0109*). The Constitutional Court is committed to observe conclusions made in its judgments to ensure stability, continuity, lawfulness and uniformity of the legal system. Only in case when a contested norm fails to comply with the factual social reality or contradicts legal relations that have become dominating ones as a result of development of the society, it is possible to reassess constitutionality of a particular norm (*see: Judgment of 25 October 2011 by the Constitutional Court in the case No. 2011-01-01, Para 14.3.1*). Therefore conclusions made in the Judgment in the case No. 2000-08-0109 shall be applied to

the present matter insofar as the factual social reality and context of legal relations has remained unchanged.

15. It has been established in case-law of the Constitutional Court that, when assessing compliance of legal norms with legal principles that follow from fundamental constitutional values enshrined in Article 1 of the Satversme, it is necessary to take into account the fact that manifestation of the principles in different legal domains may differ (*see: Judgment of 8 November 2006 by the Constitutional Court in the case No. 2006-04-01, Para 15.2 and 15.3, and judgment of 21 December 2009 in the case No. 2009-43-01, Para 21*).

In cases when compliance of any norm of the field of social rights with the principles following from Article 1, as well as Article 109 of the Satversme is contested, the Constitutional Court is committed to assess compliance of such norm with Article 1 of the Satversme in conjunction with Article 109 of the Satversme (*see, e.g.: Judgment of 1 December 2010 by the Constitutional Court in the case No. 2010-21-01, Para 13, judgment of 10 January 2011 in the case No. 2010-18-01, Para 9, and judgment of 18 February 2011 in the case No. 2010-29-01, Para 17*).

Consequently, compliance of the Contested Norms with the principle of legitimate expectations and that of a socially responsible state shall be assessed in conjunction with Article 109 of the Satversme.

15.1. Criteria, according to which compliance of a legal norm with the fundamental right to social security is assessed, may differ depending on the fact whether a particular norm restricts or not rights granted to an individual or requires or not fulfilment of a positive duty of the State.

When assessing has fulfilled its positive duties that follow from the social fundamental rights of persons, the Constitutional Court has assessed: 1) whether the legislator has performed any activities for realization of social rights; 2) whether the legislator has adequately realized the social rights, namely, whether persons had the possibility to exercise their rights at least at the minimum amount; 3) whether the legislator has not violated general legal principles (*see: Judgment of*

11 December 2006 by the Constitutional Court in the case No. 2006-10-03, Para 16.1).

However, in cases when a contested norm has restricted the rights established in Article 109 of the Satversme, the Constitutional Court shall investigate: 1) whether the restriction has been established by law or based on a law; 2) whether the restriction has a legitimate aim; 3) whether it complies with the principle of proportionality (*see, e.g.: Judgment of 6 April 2005 by the Constitutional Court in the case No. 2004-21-01, Para 10, and judgment of 21 December 2009 in the case No. 2009-43-01, Para 26*).

Cases when a contested norm concerns the core of the right to social security should be regarded differently. The Constitutional Court has indicated that, irrespective of the economic situation and even under circumstances of a rapid economic recession, the State is committed to certain basic duties that it does not have the right to ignore. One of such basic duties is guaranteeing the right to social security at least at the minimum level, and the purpose of this right is to ensure dignified existence of persons as far as possible (*see: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 31 and 31.2*).

Taking into account the aforesaid, it should be investigated how compliance of the Contested Norms with Article 109 of the Satversme would be assessed.

15.2. 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 Constitutional Court has already concluded in its case-law that social rights are very important; however they are of special and different nature because exercise of these rights depends on economic situation of each state and resources available thereto. Article 109 of the Satversme guarantees the inhabitants the right to a stable and predictable, as well as effective, fair and sustainable system of social protection that ensures a proportional social security. The right to social security in Latvia is a constitutional value (*see, e.g.: Judgment of 13 March 2001 by the*

Constitutional Court in the case No. 2000-08-0109, the concluding part, and Judgment of 15 April 2010 in the case No. 2009-88-01, Para 8).

Article 89 of the Satversme provides that "the State shall recognise and protect fundamental human rights in accordance with this Constitution, laws and international agreements binding upon Latvia". Consequently, in cases, when there is doubt about the contents of the human rights included in the Satversme, they should be interpreted in compliance with the practice of application of international norms of human rights (*see, e.g.: Judgment of 30 august 2000 by the Constitutional Court in the case No. 2000-03-01, Para 5 of the concluding part, judgment of 22 October 2002 in the case No. 2002-04-03, Para 1 of the concluding part, and judgment of 27 June 2003 in the case No. 2003-04-01, Para 1 of the concluding part*).

In the context of the case under consideration, it is important to take into account Article 9 of the International Covenant of Economic, Social and Cultural Rights (hereinafter – the Covenant), according to which the States Parties to the present Covenant recognize the right of everyone to social security, including social insurance.

The content of the Covenant is revealed, among the rest, in the General Comment published by the UN Committee on Economic, Social and Cultural Rights that was founded with the purpose to monitor implementation of the pact (*see: UN Committee on Economic, Social and Cultural Rights, General Comment No. 19, The right to social security, E/C.12/GC/19, 4 February 2008).* However, it should be taken into account that the conclusions of the above documents shall be assessed as authoritative enough viewpoint, which recommends every state to choose the optimal model of activity for the solution of a concrete problem (*see, e.g.: Judgment of 6 June 2006 by the Constitutional Court in the case No. 2005-25-01, Para 22*). However, it is not binding on the state, and all suggestions included therein shall be regarded as the ones bearing recommendatory character (*see, e.g.: Judgment of 14 September 2005 by the Constitutional Court in the case No. 2005-02-0106, Para 16*).

It is indicated in the General Comment that the duty of each state is to guarantee all peoples a minimum enjoyment of this human right to social security. This includes, among the rest, the duty of establishment of such social insurance system that generally involve compulsory contributions from beneficiaries, employers and, sometimes, the State (*see: Section 4 "a" of the General Comment*). The schemes should also be sustainable, including those concerning provision of pensions, in order to ensure that the right can be realized for present and future generations (*see: Section 11 of the General Comment*). Section 59 of the General Comment enumerates basic requirements that shall be regarded the mandatory core of rights to be ensured.

States parties should, within the limits of available resources, provide non-contributory old-age benefits, social services and other assistance for all older persons who, when reaching the retirement age prescribed in national legislation, have not completed a qualifying period of contributions or are not otherwise entitled to an old-age insurance-based pension or other social security benefit or assistance, and have no other source of income (*See: Section 15 of the General Comment*). The system should be established under national law and ensure the right of individuals and organizations to seek, receive and impart information on all social security entitlements in a clear and transparent manner (*see: Section 26 of the General Comment*). However, the Covenant does not commit to establishment of any certain model of social insurance system. Meanwhile, the obligation includes, *inter alia*, adopting the necessary and effective legislative and other measures to prevent failing to pay legally required contributions for employees or other beneficiaries into the social security system (*see: Section 45 of the General Comment*).

Consequently, in the present case, the Constitutional Court shall investigate whether the effective pension system is able to ensure the core of the social rights and whether the legislator fulfils its duty to apply respective measures to persons failing to make contributions into the social insurance system.

15.3. Article 109 of the Satversme does not regulate provisions of the pension system (*see, e.g.: Judgment of 25 February 2002 by the Constitutional Court in the case No. 2001-11-0106, Para 1 of the concluding part*). Consequently, principles of

structure and functioning of the pension system shall be an issue to be regulated by law, namely, the legislator shall have the right to concretize content of the social rights in laws.

The legislator has established the right of persons to social security established in Article 109 of the Satversme in the form of social insurance.

The Constitutional Court has made the following conclusions in its case-law: "[..] if an employee is insured for a type of an obligatory social insurance, then, when the case of insurance sets in, he/she has the right to appropriate security" (*see: Judgent of 26 March 2004 by the Constitutional Court in the case No. 2003-22-01, Para 11*). The right to receive pension pertains to the fundamental right to social security enshrined in Article 109 of the Satversme.

Since the first level is mandatory and based on the principle of social insurance, there is a connection between the mandatory social insurance contribution payments made by the residents and the level of service attained as the end result (*see: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 23*).

The second sentence of Section 5 (4) of the Social Insurance Law, in fact, establishes that the amount of old age pension granted to a person shall depend on social insurance contributions made in actual fact. The Contested Norms alters the procedure of registration of social insurance contributions depending on pension insurance.

When adopting the Contested Norms, the legislator has not restricted the fundamental right to social insurance in the old age because the right to disbursement of pension at the amount, at which a person has participated in accrual of the capital, is preserved irrespective of the procedure, according to which social insurance contributions have been registered. Consequently, the Contested Norms shall not be regarded as restriction to the right to social insurance. The Contested Norms do not apply to the positive duty of the State to form and maintain a system aimed at social and economic protection of persons having reached the retirement age because such system already exists irrespective of the procedure of registration of social insurance contributions.

In the field of social rights, the core of positive duties of the State requires ensuring only such social assistance that is guaranteed even in case if a person has made no social insurance contributions. The right of persons to social security at the minimum level is guaranteed in Para 34 of Transitional Provisions of the Pensions Law that establishes the minimum amount of pension, which, however, depends on the length of period of insurance of the person and the amount of State social security benefit. Consequently, in the present case, the right to social security at least at the minimum amount is not infringed.

15.4. Article 109 of the Satversme does not prohibit the legislator to change the existing social security system, namely, the legislator has the right to apply other mechanisms to solve certain social problems (*see: Judgment of 21 April 2010 by the Constitutional Court in the case No. 2009-86-01, Para 10*). The legislator not only elaborates legal regulatory framework of the pension system but also decides on conditions permitting introducing amendments into the pension system. Consequently, the legislator shall have the right to amend provisions of functioning of the pension system due to objective reasons and proper justification.

Character of the social rights also determines the boundaries of competence of the judicial power in respect to the particular domain. When realizing social rights the legislator enjoys an extensive freedom of action as far as it is reasonably connected with the economic situation of the State; however, this freedom of action is not unlimited (*see: Judgment of 2 November 2006 by the Constitutional Court in the case No. 2006-07-01, Para 14*). Moreover, "the Judicial Power has the duty of assessing whether the legislator has observed the limits of the above freedom of action" (*see: Judgment of 11 December 2006 by the Constitutional Court in the case No. 2006-10-03, Para 16*).

The Constitutional Court has already emphasized: If the legislator has decided to establish such pension system, wherein amount of pension depends on participation of a person in accumulation of pension capital, then Article 109 of the Satversme requires that all further activities of the State regarding such pension system would comply with the principles of a law-governed State (*see: Judgment*

of 1 December 2010 by the Constitutional Court in the case No. 2010-21-01, Para 16).

Consequently, limits of the freedom of action of the legislator, when adopting decision in the field of social rights, should comply with norms and principles of the Satversme. Consequently, the following should be investigated in the frameworks of the present case:

1) whether, by taking advantage of the freedom of action, the legislator has acted in a lawful manner, namely, in accordance with norms and principles of the Satversme, and whether provisions of functioning of the pension system have been amended based on an appropriate justification, namely, whether the normative regulatory framework under consideration is aimed at implementation of material interests of the society and protection of constitutional values;
2) whether the principle of legitimate expectations and that of a socially responsible State have been observed.

II

16. The Constitutional Court has analysed the pensions system of Latvia in several decisions already (*see, e.g.: Judgment of 19 March 2002 by the Constitutional Court in the case No. 2001-12-01, Para 1 of the concluding part, judgment of 21 December 2009 in the case No. 2009-43-01, Para 23, judgment of 1 December 2010 in the case No. 2010-21-01, Para 17, and judgment of 17 February 2011 in the case No. 2010-20-0106, Para 6.2*).

In order to establish whether the procedure of factual social insurance contributions complies with legal norms of a higher legal force, it is first necessary to establish what the principles that the pensions system of Latvia is based upon are.

16.1. In 1995, the Saeima accepted the Pension Reform Concept. The legislator's aim was to elaborate such pension system that would "ensure social

guarantees to persons that participate in its maintenance by means of making contributions" (*see: Pension Reform Concept, pp. 10*). Therefore, as from 1 January 1996, Latvia has introduced the procedure of individualized registration of social insurance contributions.

Consequently, based on social insurance contributions, the pension system guarantees substitution of income for persons having reaching the retirement age, namely, the amount of pension directly depends on incomes, from which social insurance contributions have been calculated.

According to the legislator, such pensions system "complies, at large extent, with concept of social justice because it prevents persons from concealing their employment (inhabitants are interested to make social insurance contributions and to get involved in the labour market on lawful basis) or a part of their income" (*see: Pension Reform Concept, pp. 12*).

In 1995, the Pension Reform Concept envisaged introducing a pension system of three levels that would comprise a pension scheme of generation solidarity, the funded pensions system and private pension funds. The legislator had envisaged elaborating such pension system that would be able to preserve stability disregarding economic changes (*see: Pension Reform Concept, pp. 10*). Therefore it elaborated such legal regulatory framework that would permit persons to accrue and make voluntary monetary contributions in pension funds, which would thus ensure additional pension capital (*see: Law "On Private Pension Funds" // Latvijas Vēstnesis, 20 June 1997, No. 150/151*). The legislator also elaborated a funded pension scheme in order to facilitate accruals that would serve as basis for social security system (*see: Law "On State Funded Pensions" // Latvijas Vēstnesis, 8 March 2000, No. 78/87).*

Since the second and the third pension level requires participation of individuals in accrual of pension capital, then this is the person himself or herself undertaking entire responsibility for a due pension amount.

The pension system, especially its first level is based on the principles of solidarity, justice and individual contributions. The first of the above mentioned principles requires solidarity between persons making social insurance contributions

and beneficiaries of social insurance services, namely, pensions are funded from social insurance contributions made by persons of a particular time period. The principle of justice requires that the amount of pension is proportional to the amount of social insurance contributions made and length of service of an employee. However, the principle of individual contributions provides the following: although all social insurance contributions during the entire length of service of a person are accrued in the special budget, contributions are registered, transferred and accrued in a pension contribution account of each individual. Importance of these principles to ensure successful and sustainable functioning of the pension system was stressed also by the summoned person Mr E. Voļskis (*see: Transcript of the meeting of 29 November 2011 of the Constitutional Court, Case materials, Vol. 2, pp. 110 – 120*).

16.2. The Constitutional Court has already concluded in its case-law that the social insurance system implemented in Latvia can ensure long-term availability of pension and other social services in proportion to the amount of person's participation in this system. The sustainability of pension system is based on three principles: adequacy, financial sustainability and capability to adapt itself to changes. It means that the pension system guarantees reliable and adequate income, which does not destabilise the State budget and does not put an excessive burden on future generations, at the same time ensuring justice and solidarity, as well as capacity to react on changing needs of individuals and society (*see: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 23 and 27.2*). Consequently, successful functioning of the pension system in the long term is possible only in case if the principles of solidarity, justice and individual contribution are observed and their interaction is ensured.

When considering the basic principles of functioning of the pensions system of Latvia, it can be concluded that the pension system includes, among the rest, responsibility of each person for his or her future and amount of pension. Consequently, the pension system is based on the fact that social insurance contributions are regarded as long-term investment of a person that ensures social security in the future. Moreover, the pension system is characterized by such aspect

as participation of a person during the entire period of employment. Consequently, it follows from the basic principles of the pension system that the legislator has the right to request persons' participation in capital formation and accrual.

Consequently, a person can exercise the rights established in Article 109 of the Satversme in case if he or she has participated in the pension system. In such a case, the amount of State old age pension shall be proportional to social insurance contributions made by him or her.

17. In order to assess whether, when altering provisions of functioning of the pension system, the legislator has acted lawfully, the Constitutional Court shall investigate whether the legislator has acted in the frameworks of parliamentary procedure, namely, whether the Contested Norms can be regarded as a law adopted according to proper proceedings and whether, when regulating social rights, the legislator has observed the general legal principles, including the basic principles of functioning of the pension system.

The Contested Norms form a unified and closely related legal regulatory framework because, in general, it establishes implementation of the procedure of factual social insurance contributions. Consequently, the Constitutional Court shall assess the Contested Norms as a single legal regulatory framework.

18. It has been concluded in the case-law of the Constitutional Court that the fact whether a law has been adopted according to proper proceedings, shall be assessed in accordance with Article 21 of the Satversme. It includes the principle that this is the Saeima that establishes its procedure of work [*see: Judgment of 13 July 1998 by the Constitutional Court in the case No. 03-04(98), Para 3 of the concluding part, judgment of 22 February 2002 in the case No. 2001-06-03, Para 5 of the concluding part, and judgment of 16 December 2008 in the case No. 2008-09-0106, Para 6.1*].

On 20 December 2010 the Saeima adopted the Contested Norms in the frameworks of the package of draft budget laws.

The State budget as a policy planning document of economic nature includes not only a concretized estimates of income and expenses – body of financial means, but also body of measures that ensure redistribution and allocation of the resources among different groups of the society. The legislator is committed to monitor whether the State budget has enough funds, as well as to elaborate an appropriate mechanism for ensuring welfare of the society. Therefore the Saeima Rules of Procedure establish a special procedure for adoption of the State budget. Section 87.[1] of the Saeima Rules of Procedure provides that the draft budget law and budget-related laws shall form the package of draft budget laws. Since planning of funds of the State budget is based on public income and expenditure estimates, the legislator shall have the right and the duty to regulate, in the package of draft budget laws, only such issues that are related to a particular economic year and are closely linked with use of public finances.

The Constitutional Court has already indicated that the special budget of social insurance is a part of the State budget. Consequently, a financial link exists between these two budgets. As revenues or expenses of the special budget of social insurance change, balance of the entire State budget is influenced (*see: Judgment of 15 March 2010 by the Constitutional Court in the case No. 2009-44-01, Para 21*).

Section 1 (1) of the Law "On Taxes and Fees" provides that mandatory contributions for State social insurance shall be regarded as tax. Consequently, the Contested Norms are closely related to incomes of the special budget and planning thereof. The legal regulatory framework included in the Contested Norms exceeds frameworks of one economic year; however, the situation in the special budget required immediate action and it was necessary to elaborate such legal regulatory framework that would be aimed at assurance of financial sustainability of the budget.

Paragraph 2.[1] of Section 21 of the draft Social Insurance Law contained a suggestion of the responsible committee, i.e. the Saeima Budget and Finance (Taxation) Committee proposed for the second reading of the draft law. The Constitutional Court has already indicated that the Saeima Rules of Procedure

commits a part of the work regarding preparation of draft laws to Saeima committees. A responsible committee shall ensure that a draft law would be prepared in an appropriate way when submitting it to review at Saeima meetings (*see: Judgment of 16 December 2009 by the Constitutional Court in the case No. 2008-09-0106, Par 6.4, and judgment of 30 October 2009 in the case No. 2009-04-06, Para 11.2*).

Minutes No. 19 and No. 23 of 10 and 16 December 2010 meetings of the Saeima Budget and Finance (Taxation) Committee do not reflect argumentation that served as grounds for adoption of the particular legal regulatory framework, namely, the Saeima Legal Bureau, in its opinion, drew attention of the Saeima to the fact that, when performing an initial assessment, it seems that the Contested Norms contradict the conclusions made in the Judgment in the case No. 2000-08-0109 (*see: Case materials, Vol. 1, pp. 45 – 64*).

The Constitutional Court has already drawn attention of the Saeima to the fact that failure to reflect assessment of substantial conclusions in minutes of committee meetings does not permit obtaining a full insight into course of committee meetings and decisions taken during them (*see: judgment of 19 October 2011 in the case No. 2010-72-0106 , Para 18.4*). However, in the case under consideration, the above mentioned consideration neither substantiates nor excludes compliance of the Contested Norms with the Satversme.

In the present matter, there is no dispute regarding the fact whether the Contested Norms have been proclaimed according to the proceedings established in the Satversme and the Saeima Rules of Procedure.

The Contested Norms have been adopted and proclaimed according to proper proceedings.

19. The Saeima indicates that the Contested Norms have two mutually related aims, namely, the aim to balance budget incomes and expenses and to ensure rights of other persons to social security by guaranteeing that these rights would be exercised also in the future. The Saeima holds that the Contested Norms shall be regarded as one of the measures aimed at combat against shadow economy.

The Constitutional Court has already recognized that the aim to balance incomes and expenses of the State pension special budget is a material consideration in the field of social rights. The funds of the special State pension budget mainly consist of mandatory and voluntary payments to pension insurance. Besides, it is essential to avoid shortage of the State pension special budget. Moreover, it is necessary to ensure the possibility of pension payment in future, when the demographic situation may possibly be different (*see: Judgment of 11 November 2005 by the Constitutional Court in the case No. 2005-08-01, Para 8*).

Taking into account the fact that the duty to form a sustainable pension system is based on the right to social insurance, the legislator is committed to balancing financial possibilities of the special budget not only with rights of persons in the social field but also the necessity to ensure welfare of the entire society. Responsibility for balancing of the special budget and reasonable use of its funds is the duty of the State. Consequently, the self-funding principle of the special budget relates the fundamental rights of a person with balance of incomes and expenses of the particular budget.

Shadow economy is characterized, at large extent, by illegal employment, tax avoidance, "envelope" salaries, failure to provide receipts for transactions, double bookkeeping and other unlawful actions. Shadow economy serves as a gateway for disproportional competition, deforms the market and has a negative impact on tax collection indices (*see: 29 January 2004 Cabinet of Ministers Order No. 60 "Basic Guidelines "On Measures to Reduce Illegal Employment"", page 3 of the informative part*).

The State President Strategic Analysis Committee has also indicated that the majority of the society is ready not to fulfil their duties in front of the State by avoiding taxes in case if it could immediately improve their material situation (*see: Report of the State President Strategic Analysis Committee on the mood of the society in 2009, Para 6; http://polsis.mk.gov.lv/view.do?id=3168, consulted on 6 December 2011*).

Since no taxes are paid regarding persons who are illegally employed, the tax burden is undertaken by those employers and employees who do pay their taxes.

Consequently, illegal employment has a negative influence also on the balance of the social budget and hampers financial sustainability of it.

It is possible to agree with the opinion of the Applicant that monitoring of fulfilment of duties of employers and combat against shadow economy is the task of the State. However, it is also true, based on the position of the Saeima, that taking measures to combat shadow economy without involvement of concerned persons and the entire society will not turn out to be effective. One of the preconditions of democracy is active participation of the entire society in measures related to quality of the socio-economic life of the inhabitants. Assurance of needs of the society requires active civil participation and the fact that inhabitants of the State would undertake common responsibility for sustainable development of the State.

In 27 May 2010 Cabinet of Ministers Order No. 287 "On Action Plan to Combat Shadow Economy", it is indicated that is necessary to elaborate "a system for society information/education in order to provide information on use of collected tax and all benefits that a tax payer would obtain when paying taxes".

The legal regulatory framework included in the Contested Norms that establishes that amount of pension of a person would be related to the total sum of social insurance contributions made could facilitate willingness of persons to pay taxes. The fact that the Contested Norms reduce proportion of shadow economy shall be regarded as a positive side effect aimed at protection of welfare of the society.

The Contested Norms are aimed at ensuring sustainability of the pension system by balancing incomes and expenses of the special budget and thus facilitating welfare of the entire society and protection rights of other persons

The Contested Norms have been adopted with the purpose to protect material interests of the society and protection of constitutional values.

20. The Constitutional Court has already established that usually the political dimension of the decisions of the state and especially its legislator in realization of social rights is important, namely, decisions in this sector are usually adopted more on the basis of political and not legal reasons; and they in their turn depend on the

conception of the legislator about the principles of rendering state social services, economic situation of the state and the public – or its part – special necessity for aid or support of the state (*see: Judgment of 8 November 2006 by the Constitutional Court in the case No. 2006-04-01, Para 16*).

The Ministry of Welfare indicates that other measures that would ensure sustainability of the pension system and the special budget are less advantageous for persons and could cause a range of unfavourable socio-economic consequences. Since the special budget is formed from social insurance contributions, then it is possible to ensure savings therein either by increasing the social insurance contributions rate or by reducing the amount of social security for persons.

The legislator enjoys a broad freedom of action when selecting the most appropriate legal regulatory framework for implementation of the rights established in the Satversme. In the present case, the task of the Constitutional Court is to assess compliance of the Contested Norm with the fundamental rights enshrined in the Satversme rather than to substitute freedom of action of the legislator by its own opinion on the most rational solution.

In order to assess whether the legislator has or has not exceeded limits of its freedom of action when selecting the most appropriate solution for implementation of the fundamental rights established in Article 109 of the Satversme, the Constitutional Court shall investigate whether the principle of legitimate expectation and that of a socially responsible state have been observed.

21. It has been indicated in the application that the Contested Norms fail to comply with the principle of legitimate expectations that follows from Article 1 of the Satversme. The representative of the Applicants indicated that, when introducing the new legal regulatory framework, the right of a person to social security in the old age are affected at a considerable rate. By failing to establish a transitional period before coming into force of the new legal regulatory framework and cancelling the procedure of declared social insurance contributions, the legislator has infringed the principle of legitimate expectations enshrined in Article 1 of the Satversme.

The principle of legitimate expectations means that a person can trust into the fact that his rights and legal interests once granted would not be denied. In the basis of this principle, lies the trust that the State would act in a lawful and consistent manner. Its main task is to protect the rights of a person in cases, when – as the result of amendments to legal regulation – the legal status of an individual is or may be worsened (*see: Judgment of 8 November 2006 by the Constitutional Court in the case No. 2006-04-01, Para 21*). However, the principle of legitimate expectations does not exclude the right of the State to amend existent regulatory framework (*see: Judgment of 1 December 2010 by the Constitutional Court in the case No. 2010-21-01, Para 19*). The principle of legitimate trust among other things determines also the fact that the rights, once acquired by an individual, cannot exist for an unlimited time. Namely, this principle does not serve as the basis for expectation that the once determined legal situation will never change (*see: Judgment of 25 October 2004 of the Constitutional Court in the case No. 2004-03-01, Para 9.3*).

The Contested Norms were adopted on 20 December 2010 and came into effect on 1 January 2011. The procedure of factual social insurance contributions was applied to social insurance contributions to be made in the future. The Contested Norms do not affect social insurance contributions that were made in accordance with the declared social insurance contributions procedure. Consequently, amendments to the legal regulatory framework do not deteriorate legal status of private persons.

The Constitutional Court concludes that the Contested Norms does not commit a person to new duties. A person does not have the duty to request information, on regular basis, regarding the fact whether the employer has duty lade social insurance contributions; this is regarded as right of a person. Consequently, in this case, the legislator did not have to establish any transitional period for persons to be able to adapt to the new situation.

The Contested Norms do not infringe the principle of legitimate expectations; therefore it is not necessary to assess compliance of the Contested Norms with the above mentioned principle.

22. The duty of the State to form a sustainable and balanced policy to ensure welfare of the society follows from the principle of a socially responsible state. Therefore the legislator has to elaborate such regulatory framework that would be aimed at sustainable development of the State (*see: Judgment of 1 December 2010 in the case No. 2010-21-01, Para 21.3*).

The Constitutional Court has already concluded in its case-law that the situation in the social budget is closely related with the overall economic situation of the State, which is characterized by low economic activity. The above mentioned has caused drop in the amount of social insurance contributions (*see: judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 27.1, and judgment of 15 March 2010 in the case No. 2009-44-01, Para 20*).

For several years already, the demographic situation of Latvia is negative because the society is ageing, namely, the birth rate and the average life expectancy are low. Ageing of the society is a serious risk for stability of the social insurance system now and in the future (*see: Informative part of the Concept, pp. 5, http://polsis.mk.gov.lv/view.do?id=3518, consulted on 2 December 2011; the Concept was approved by 17 November 2010 Cabinet of Ministers Order No. 647 // Latvijas Vēstnesis, 23 November 2010, No. 185*). Moreover, it is necessary to take into account data of the Central Statistical Bureau [*Centrālā statistikas pārvalde*] that show that the migration balance of Latvia is negative, as well as death rate of able-bodied inhabitants has increased (*see: Par Latvijas iedzīvotāju vecumsastāva izmaiņu tendencēm http://www.csb.gov.lv/notikumi/par-latvijas-iedzivotaju-vecumsastava-izmainu-tendencem-32045.html, consulted on 7 December 2011).*

It is evident that the economic and demographic situation in the State has also affected the stability of the social insurance special budget, and the Saeima and the Cabinet of Ministers, in this situation, were obliged to take action in order to ensure the welfare of society in a long-term perspective (*see: judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 27.2*).

The Constitutional Court has indicated that the legislator must consider impact of each decision on sustainability of the pension system and take timely measures to prevent economic and demographic risks. By failing to timely prevent

all risks, the pension system can be weakened so much that restoration of its normal functioning would require even more time and greater amounts of resources (*see: Judgment of 1 December 2010 by the Constitutional Court in the case No. 2010-21-01, Para 20.3*).

The Constitutional Court has already concluded in its case-law that the decisions adopted in haste and without sufficient prior deliberation, along with the economic situation in the State, have caused the current difficult situation in the social insurance special budge (*see: Judgment of 21 December 2009 by the Constitutional Court in the case No. 2009-43-01, Para 31.1.2*). In this case, too, the Constitutional Court concludes that the financial sustainability of the special budget is threatened by several problems that have not yet been properly solved (*see: Transcript of the meeting of 29 November 2011 of the Constitutional Court, Case materials, Vol. 2, pp. 83 – 93*).

The Constitutional Court cannot act on behalf of the legislator and point to the most appropriate decisions or determine who State budget resources should be allocated. In the present case, the duty of the Constitutional Court is to draw attention of the legislator to the necessity to find solution to the particular situation. The excessive hesitation of the legislator when deciding how to ensure financial sustainability of the special budget causes risk of infringement of interests and fundamental rights of people. Measures that permit adjusting the special budget in a short time do not prevent causes of financial problems of the special budget. Lack of a well-considered and balanced long-term policy, as well as absence of economically grounded measures proves that existence of the pension system and the special budget is threatened.

23. Successful functioning of the pension system is closely related with trust of people into the system and their will to make social insurance contributions. Therefore individual should be informed on the possibility to ensure oneself with an adequate amount of pension in the old age in the frameworks of different pension levels.

Unclear, complicated and unstable pension system reduce willingness of persons to participate therein. The legislator should facilitate stability by providing clear information on functioning of the pension system and its future social policy. Functioning of the pension system should persuade the society that the amount of pension would be determined by the amount of social insurance contributions pursuant to the pension calculation scheme established in normative acts. Only after this a person would be able to adopt balanced and reasonable decisions to assure one's pension.

Pursuant to the principle of good administration, the State has the duty to ensure that each person in particular and the entire society in general would be duly and timely informed on fundamental functioning principles of the pension system. Based on the court file and opinions heard during the court hearing, the Constitutional Court did not find any proofs that, at present, every person understands how the factual social insurance contributions procedure impacts estimates and amount of pension.

It should also be indicated that, due to the above mentioned circumstances, social insurance contributions could diminish, which would imply considerable drop in incomes of the special budget. Lack of financial resources would prohibit the State guaranteeing the right to social security in the old age to persons who would have had participated in the pension system. It should also be taken into account that, to ensure social insurance services, an enormous burden is carried by those persons regarding whom social insurance contributions are made; this, in fact, threatens effective implementation of the solidarity principle. Social justice requires that the special budget resources would first be used to finance pensions of those persons who have duty participated in accrual of pension capital. The Saeima has also recognized in its reply that the State does not have to undertake responsibility for those persons who have failed to pay enough attention to the fact whether their employers have or have not made social insurance contributions regarding them by thus fulfilling their stipulated duties; but instead they have trusted to the fact that, in the case of need, the State would still provide them social aid.

24. When assessing compliance of the Contested Norm with the principle of a socially responsible state, the main criterion is the fact whether the solution selected by the legislator is a socially responsible one. A socially responsible solution is such a solution, in the result of which legal interests of certain persons are balanced with those of the society. Therefore, it is necessary to assess measures selected by the legislator to ensure a lenient transitional period in conjunction with the necessity to ensure balance between economic possibilities of the State and welfare of the entire society. A socially responsible state under the particular circumstances could be based not only to provision of a lenient period for the transition to the new legal regulation but also on the fact that along with the amendments to normative acts, a person is given the possibility to implement the rights once conferred by the State, all this being based on financial possibilities of the State (*see: Judgment of 15 March 2010 by the Constitutional Court in the case No. 2009-44-01, Para 22*).

The Saeima holds that, by means of the Contested Norms, the legislator performs socially responsible reforms that are necessary for observance of interests of the society. Consequently, adoption of the Contested Norms shall be regarded as a socially responsible solution, namely, such solution that has resulted on coordination of legal interests of individuals with those of the entire society.

In the Judgment of 15 March 2010 by the Constitutional Court in the case No. 2009-44-01, the term "socially responsible solution" is used in the context of reforms. The procedure of registration of social insurance contributions established in the second sentence of Section 5 (4) of the Social Insurance Law can be regarded as a reform of the social insurance system because the amount of pension may change if it is calculated taking into account factual rather than declared social insurance contributions. Moreover, the second sentence of Section 5 (4) of the Social Insurance Law has been adopted with the purpose to protect material interests of the society because, when adopting the Contested Norms, the legislator was trying to improve the social insurance system in order to ensure it sustainability, as well as increased the possibility of a person to participate in the system.

The Constitutional Court concludes that the procedure of factual social insurance contributions does comply with the principles that follow from the

Satversme, namely, it ensures that a fair amount of pension of a person, i.e. it is proportional to social insurance contributions made and depends on the level of participation of a person in formation of pension capital. Sustainability of the pension system is also ensured because following generations would have the right to receive pension in accordance with social insurance contributions made in actual fact. By introducing the factual social insurance contributions procedure, the legislator has observed principles that follow from the Satversme and has acted in the frameworks of its freedom of action.

Consequently, the procedure of factual social insurance contributions procedure does comply with the principle of a socially responsible state and therefore the second sentence of Section 5 (4) of the Social Insurance Law does comply with Article 1 and Article 109 of the Satversme.

III

25. The Constitutional Court has already concluded that tax is a precondition of a nationally organized society and an indispensable part of the State policy. Tax income form a substantial part of the State budget incomes, which ensures the capacity of the State to fulfil its functions and duties in the field of protection of the fundamental rights. The fact that a person working in Latvia has the duty to pay taxes established by the legislator indirectly follows from Article 73 of the Satversme (*see: Judgment of 6 December 2010 by the Constitutional Court in the case No. 2010-25-01, Para 9*).

Implementation of the fundamental principle of the financial life of the State is regulated by Article 66 of the Satversme by providing that, annually, before the commencement of each financial year, the Saeima shall determine the State Revenues and Expenditures Budget, the draft of which shall be submitted to the Saeima by the Cabinet. If follows from the above mentioned constitutional norm that, on the one hand, the legislator has the right to establish such regulatory framework for ensuring welfare of the society that it regards as necessary. On the

other one, the legislator is also committed to establishing an appropriate mechanism to assure observance of such regulatory framework (*see: Judgment of 20 May 2011 by the Constitutional Court in the case No. 2010-70-01, Para 13*).

Consequently, when establishing the social insurance system to implement the fundamental right of persons to social security guaranteed in the Satversme, the legislator has a constitutional duty to form an effective mechanism for implementation of these legal norms.

Taking into account the fact that the pension system establishes the participation duty to individuals in order to ensure a due amount of pension, the State has to ensure an effective monitoring of administration of social insurance contributions and protection of accrued pension capital in the long term.

The legislator has established in Section 21 (2) of the Social Insurance Law that an employee shall make mandatory contributions through his or her employer. The employer shall deduct the contributions to be made by the employee and pay them into a special budget account.

Since social insurance contributions are regarded as a tax, the legislator is constitutionally bound to establish a due and effective mechanism to ensure administration of the particular tax. Proper tax administration includes timely and efficient tax collection and at the same time prevents tax evasion (*see: Judgment of 11 April 2007 by the Constitutional Court in the case No. 2006-28-01, Para 13 and 19.1*). Undue fulfilment of constitutional commitments of the legislator threatens such constitutional value of welfare of the society.

Consequently, on the one hand the legislator is committed to maintain the pension system in at the administrative level, namely, to ensure that normative acts give each person the possibility to accrue pension capital. However, on the other hand, the legislator is committed to create a compulsory mechanism to ensure tax collection with the purpose to reduce ungrounded reduction of social security level of employees in case if the employers fail to observe normative acts.

Consequently, responsibility for a sustainable pensions system is divided between the State, employers and employees.

The Contested Norms neither cancel the constitutional commitment of the employer to make stipulated social insurance contributions, nor releases the legislator from its constitutional duty to establish such mechanism that would permit the executive power to duty ensure social insurance contribution collection.

Consequently, a person shall have the right to require the employee to make and the State to collect social insurance contributions.

26. In the Judgment in the case No. 2000-08-0109, the Constitutional Court concluded that "the Law does not envisage the duty or possibility of the insured person to control the employer – the executor of the social insurance contributions".

At the court hearing, the representative of the Saeima and that of the Ministry of Justice indicated that normative acts provide employees with the possibility to control whether and how the employer makes social insurance contributions regarding him or her.

Consequently, the Constitutional Court is committed to assess whether an effective mechanism has been establish that would ensure that a person would be able to obtain information on the fact whether the employer and the legislator have duty fulfilled their constitutional duties, namely, whether social insurance contributions have been made and registered according to the procedure established by law.

27. According to Section 71 of the Labour Law, when paying work remuneration, an employer shall issue a written calculation of the work remuneration in which the work remuneration disbursed, including the taxes deducted and the mandatory State social insurance payments made. Since, according to Section 69 (1) of the Labour Law, work remuneration is paid at least once per month, an employee is furnished with information of social insurance contributions made on regular basis.

Moreover, Section 23 (4) of the Social Insurance Law provides that the State Social Insurance Agency [SSIA], on the basis of a socially insured person personally

requesting or submitting in writing a request at any office of the State Social Insurance Agency, shall issue or send without charge information regarding the status of the insurance accounts of such person. Moreover, a person can submit a distance-request in the SSIA information system to obtain information on social insurance contributions made by the employer, namely, in the portal *www.latvija.lv* provides access to information on social insurance payments and insurance periods. Any person can receive this information online.

Consequently, information on the fact whether the employer has made social insurance contributions in actual fact can be verified. It is also possible to draw attention of the employer and State institutions to the fact that the stipulated duty has not been fulfilled in a due manner.

Due to this reason, it should be noted that any person shall have the right rather than the duty to monitor accrual of one's pension capital. However, a person should take into account the fact that failure to exercise such right might impact the amount of old age pension to be granted.

Each person is ensured an effective possibility to receive information on the fact whether the employer has made social insurance contributions in a due manner.

28. State institutions that monitor collection of social insurance contributions and other issues related to employment have to fulfil their stipulated duties in a due manner and assure implementation of social rights of individuals.

For the factual social insurance contributions procedure not to have a negative impact on pension insurance, it is important to ensure an effective functioning of tax administration (*see: Draft law "Amendments to the Law "On State Social Insurance'", Initial Impact Assessment Report (Annotation), Para 4 of Section 1*).

At the court hearing, the representative of the SRS indicated that, after applying recovery measures, in ten months of 2011, in total 59.6 million lats were collected in the form of social insurance contributions. Along with the change of general principles of social insurance by introducing the factual social insurance

contribution procedure in respect to state old age pension insurance, the SRS has revised priorities of work organization in order to ensure effective tax collection. At present, the task of the SRS is to get timely aware of debtors of social insurance contributions and to transfer the confirmed tax surplus payments to cover social insurance contribution debts. Moreover, tax payers can be granted extension of the term for covering social insurance contribution debts based on justified and well-considered facts and taking into account provisions of Section 24 of the Law "On Taxes and Fees". The priority of the procedure for recovery of tax debts is collection of social insurance contribution debts and also timely recovery of delayed payments. The SRS pays a particular attention to those debtors whose employees would reach the retirement age in the near future. If preventive measures are taken though the debt is not covered, the SRS launches an undisputed recovery of tax debts (*see: Transcript of the meeting of 15 November 2011 of the Constitutional Court, Case materials, Vol. 1, pp. 56 – 65*).

In the informative report "On Impact of Factual Social Insurance Contributions Procedure for Pension Insurance to Social Security of Persons", it is indicated that 209 thousands or 85.6 per cent of employees aged above 50 have their social insurance contributions made at full extent, whilst 24.9 thousand or 10.2 per cent of employees – only partially. Meanwhile, no social insurance contributions have been made regarding 5.1 thousand or 2.1 per cent of employees. It is indicated in the report that social insurance contributions have been made regarding 95.8 per cent of employees aged above 50.

The State has established an appropriate mechanism to ensure that employer would make the stipulated social insurance contributions.

29. Along with collection of social insurance contributions and the possibility to obtain information on the amount of social insurance contributions, it is also necessary to assess those mechanism that ensure protection of rights of persons in case if the employer has failed to make any social insurance contributions or has done it only partially.

The representative of the Saeima and that of the Ministry of Welfare indicate that, in such a case, a person can apply to public institutions, like the State Revenue Service or the State Labour Inspection that monitor and control compliance of legal labour relations with normative acts. Pursuant to the Law "On Protection of Employees in Case of Insolvency of Employer", the created fund protects rights of employees to wage and ensures making of social insurance contributions regarding them. It is also established in the Insolvency Law that an employee shall have the right to submit an application regarding insolvency of the employer in case if it has failed to disburse full salary or has failed to make social insurance contributions for the period of two months as from the stipulated date. Moreover, Section 21 ($2.^1$) of the Social Insurance Law provides that, in certain circumstances, the person shall have the right to make social insurance contributions regarding him or her in case if the employer has failed to do so.

Since each of the above mentioned mechanisms establishes different preconditions for implementation of control, they should be assessed separately.

30. The right of a person to submit an application regarding insolvency of the employer may not be regarded as an effective mechanism for implementation of social fundamental rights of a person due to the above mentioned conditions.

First, Section 57 (4) of the Insolvency Law provides that one of the features of an insolvent legal person is the fact that „the debtor has not [..] carried out the mandatory social insurance payments within two months following the day specified for payment". However, as to such cases, the legislator neither has established a simplified procedure for protection of their rights, nor released them from payment of the State fee established in the Civil Procedure Law and the duty to pay a deposit at the amount of two minimum monthly wages as established in Section 62 (1) of the Insolvency Law. Consequently, a person has to foresee additional expenses for him or her to be able to recover social insurance contributions failed to be made by the employer.

Second, Section 2 (2) of the Insolvency Law provides that in respect of the State, self-government or other legal person governed by public law the insolvency

proceedings and legal protection proceedings specified in this Law shall not be applied.

Third, in case of initiation of insolvency procedure whenever an employer has failed to make social insurance contributions for two months from the stipulated date, this could threaten its economic activity because insolvency procedure against an employer also means that the employee would most likely lose the working place due to liquidation of the commercial company owned by the employer.

31. Section 21 (2.[1]) of the Social Insurance Law provides that, having reached the retirement age, a person shall have the right to make social insurance contributions for pension insurance in case if the employer has failed to do so.

In fact, this norm is dispositive, namely, a person may choose either to make or not social insurance contributions failed to be made by the employer. Consequently, this is up to the person, having assessed all circumstances, to adopt an economically grounded decision on the necessity to increase one's pension capital by making social insurance contributions failed to be made by the employee and failed to be collected by public institutions. The norm does not commit a person to making social insurance contributions because the person may wait until the competent public institution would recover unpaid social insurance contributions from the employer.

According to the Constitutional Court, Section 21 (2.[1]) of the Social Insurance Law is advantageous to individuals because it provides them the possibility to influence the amount of their pension capital in case if their employer has failed to make social insurance contributions according to the stipulated procedure.

The Constitutional Court also draws attention of the Saeima to the fact that the Cabinet of Ministers has considerably delayed elaboration of procedure, according to which a person can make social insurance contributions regarding pension insurance. The Cabinet of Ministers as an institution of the executive power was committed to immediately ensure implementation of the law and to adopt respective provisions in the shortest time period possible. However, the inactivity of

the Cabinet of Ministers cannot serve as grounds to prohibit a person to exercise his or her stipulated rights.

It should also be taken into consideration that, the majority of debt of social insurance contributions appears for a short period of time – it lasts as long as public institutions recover unpaid social insurance contributions. Pursuant to the information furnished by the SRS, the average duration of debt of social insurance contributions is two years and six months. The situation can be solved in two ways: either by covering the debt of social insurance contributions, which would cause no negative consequences to a person, or to compensate the unpaid social insurance contributions from the Employee Claims Guarantee Fund pursuant to the law "On Protection of Employees in Case of Insolvency of Employers", which would neither cause any negative consequences.

Moreover, Para 23 of Transitional Provisions of the Pensions Law provides: If the right to increase the pension are obtained in relation to supplementary insurance contributions for the period before the pension was granted (recalculated), the pension shall be recalculated from the day it was granted (recalculated). The Law also establishes that the recalculation of a pension shall be carried out not more often than once every half year. This means that in case if social insurance contributions regarding pension insurance for the period before granting of the pension are supplemented, namely, the employer would cover the debt or the debt would be covered from the Employee Claims Guarantee Fund, the pension would be recalculated as form the date when it is granted based on an application of a person but not more often than one every half year. When recalculating pension, the difference in amount of pension already disbursed and the one calculated would be calculated and disbursed to the person. Consequently, a person would receive a due pension.

Consequently, Section 21 ($2.^1$) of the Social Insurance Law shall be regarded as one of the elements that ensure the possibility of persons to take an effective part in accrual of their pension capital. Moreover, all above mentioned mechanisms shall be considered in a complex manner, namely, a person can monitor accrual of one's pension capital and thus verify whether the employer has fulfilled their stipulated

duties in a due manner. Should the person establish that no social insurance contributions have been made, it can apply to public institutions, the task of which is to prevent non-observance of normative acts. Consequently, the legal regulatory framework of Section 21 (2.[1]) of the Social Insurance Law shall be regarded as an ultimate measure for assurance of an adequate pension capital. Moreover, it is a provisional measure because social insurance contributions made by a person are reimbursed as soon as the SRS would have recovered respective debt from the employer. However, it should be noted that a person does not have the duty to take advantage of the legal regulatory framework of Section 21 (2.[1]) of the Social Insurance Law.

The second sentence of Section 5 (4) and Section 21 (2.[1]) of the Social Insurance Law, in fact, do not apply to the issue of the constitutional duty of the legislator to collect social insurance contributions in a due manner.

It is of great importance that the legal regulatory framework of the Contested Norms shall be reassessed on regular bases, namely, Para 49 of Transitional Provisions of the Social Insurance Law commits the Cabinet of Ministers and the Saeima to reviewing effectiveness of the legal regulatory framework of regular basis. Should it be concluded that the mechanism established in the Contested Norm fails to ensure the planned effect, the Saeima and the Cabinet of Ministers shall have the duty to take necessary measures to prevent all negative consequences.

By introducing the factual social insurance contribution procedure, the legislator has taken measures to stabilize the pension system and has established a due mechanism for implementation of the procedure; moreover, persons have been given the possibility to get involved in formation and accrual of their pension capital.

Consequently, the second sentence of Section 5 (4) and Section 21 (2.[1]) of the Social Insurance Law shall be regarded as compliant with Article 1 and Article 109 of the Satversme of the Republic of Latvia.

The Ruling

Based on Article 30 – 32 of the Constitutional Court Law, the Constitutional Court

h o l d s :

The second sentence of Section 5 (4) and Section 21 (2.[1]) of the Law "On State Social Insurance" complies with Article 1 and Article 109 of the Satversme of the Republic of Latvia.

The Judgment is final and not subject to appeal.

The Judgment shall come into force on the date of publishing it.

The Judgment was declared on Riga, on 20 December 2011.

Presiding Judge G. Kūtris

Translated by E. Labanovska, translator of the Constitutional Court