Case No 2009-43-01*

Name of the Court:

Constitutional Court

Parties:
Ilmārs Drēziņš et al. v the Parliament

Type of action/procedure:

Constitutional complaint (Article 85 Constitution and Articles 16(1), 17(1)(3)and 17(1)(11), $19.^{2}$ and $28.^{1}$ Constitutional Court Law

Admissibility issues:

The cases concerning both the compliance of Article 2, Paragraph One of the Disbursement Law with Articles 1 and 109 of the Constitution and the compliance of Article 3, Paragraph One of the Disbursement Law with Articles 1, 91, 105 and 109 of the Constitution were declared admissible in the Constitutional Court.

Legally relevant factual situation:

On 16 June 2009 the Parliament of the Republic of Latvia adopted the Law on State Pension and State Allowance Disbursement in the Period from 2009 to 2012 (hereinafter – the Disbursement Law). The purpose of this law is stated in Article 1: „*to provide persons with social security within the limits of the available financing according to the laws on State budget for the current year in the period from 1 July 2009 to 2012*."

According to the Disbursement Law, cuts of particular payments from the special budget of social insurance were established for the above mentioned period. Thus, Article 2, Paragraph One of the Disbursement Law stipulates that „*in the period from 1 July 2009 to 31 December 2012 the state old-age pensions and service pensions granted according to the by-laws 'On Service Pensions' and 'On the Rank and File and the Unit Commanding Personnel of the Institutions of the Ministry of the Interior Employee Pensions (Employer Pensions)' are paid in the amount of 90 percent from the pension amount granted in accordance with the legislative acts*".

Whereas Article 3, Paragraph One of the Disbursement Law prescribes that "*in the period from 1 July 2009 to 31 December 2012 the recipients of state old-age pensions and service pensions granted according to the by-laws 'On Long Service Pensions' and 'On the Rank and File and the Unit Commanding Personnel of the Institutions of the Ministry of the Interior Employee Pensions (Employer Pensions)' are paid in the amount of 30 percent from the pension amount granted in accordance with the legislative acts starting with the first date of the month following the month when the recipient of pension has become a person subject to mandatory social insurance (employee or self-employed) in accordance with the Law on State Social Insurance*" (hereinafter Article 2, Paragraph One and Article 3, Paragraph One of the Disbursement Law jointly – the impugned provisions).

Legal questions:

Whether Article 2, Paragraph One of the Disbursement Law is compatible with Articles 1 and 109 of the Constitution and Article 3, Paragraph One of the Disbursement Law with Articles 1, 91, 105 and 109 of the Constitution?

Arguments of the parties:

Applicants: They pointed out that several basic legal principles follow from Article 1 of the Constitution – the principle of protection of legitimate expectations, the principle of proportionality, the principle of the rule of law, the principle of social state, the principle of good governance and the principle of social solidarity. The legislator, by adopting the impugned provisions that prescribe a 10 percent cut of old-age pension granted for life for unemployed pensioners and 70 percent cut for employed pensioners, has violated these principles.

Recipients of old-age pension are a special group of society because the granted pension is predominantly the only source of income for them. Therefore, there is no doubt that persons who qualify for old-age pension have relied upon the legal order for calculation and granting of old-age pension, and this reliance has been lawful, reasonable and justified. The legal order was in force for a long period of time and it was sufficiently stable and unchanging. Although the economic situation in the country has deteriorated, the principle of protection of legitimate expectations still has a major role in the existence of a state governed by the rule of law. The state has an obligation to provide judicial stability, whereas persons have the right to rely upon the state fulfilling its obligation in good faith. The situation when a decision crucial for the state is adopted urgently in two-day time is also unacceptable. The legislator has not envisaged the obligation to compensate or repay the deducted reduction of state pensions to the recipients of old-age pension. On the contrary – the Parliament has rejected the proposal that envisaged the procedure for repaying the deducted share of pensions (para. 2.1).

The Applicants proceeded that, when determining compliance of the impugned provisions with the principle of proportionality, one should bear in mind that benefit for the society from adopting a certain legal provision or legal order should be greater than detriment to legal interests of a person. Furthermore, the legislator should assess the influence of the legal provision to be adopted on each group of persons who are affected by the provision. The Applicants admitted that the economy of the state budget funds could by itself be the legitimate end of the impugned provisions; however, the economy of the state budget funds at the expense of such an unprotected group of society, namely, the recipients of old age pensions, is unacceptable (para. 2.2).

Lack of consultations with experts during preparation of the draft law was also considered as its substantial drawback by the applicants. Thus, the fiscal effect of the provision has not been duly assessed; moreover, it can even be disputed. Likewise, there is no substantiation as to why the legislator has included the particular amount of pension disbursement decrease in the impugned provisions, i.e. 70 percent. The Applicants also dispute the allegation that the impugned provisions have been adopted because the international creditors – the European Commission and the IMF had required so (para. 2.3). According to the Applicants, Article 3, Paragraph One of the Disbursement Law disproportionately restricts the property rights of a person since the calculated pension remains the same, whereas only 30 percent from the calculated pension is disbursed. Thus the essence of property rights is violated and further trust to the whole pension system is diminished (para. 2.3).

The Applicants asked the Constitutional court to declare Paragraph One of Article 2 of the Disbursement Law incompatible with Articles 1 and 109 of the Constitution and Paragraph One of Article 3 as incompatible with Articles 1, 91, 105 and 109 of the Constitution as well as to declare both impugned provisions invalid as of the moment of their adoption.

Respondent (the Parliament): When determining the conformity of the impugned provisions with the Constitution, factors related to the economic situation in the country and resources of the State budget of Latvia cannot be ignored. Since 2008, economic development has considerably deteriorated. The drop in Gross Domestic Product in the second quarter of 2009 was 19.6 percent in comparison with the same period of the previous year. Therefore, more efficient steps to prevent the decline of the state economy were required. In accordance with the Declaration of the Intended Activities of the Cabinet of Ministers issued on 11 March 2009, the government has undertaken to achieve reduction of the budget deficit. The need for such a reduction followed both from the commitments to the European Commission and IMF as well as from determination to stop the economic recession in the country. The sharp decline in economic activity caused the considerable decline in the state budget revenues as well. Therefore a substantial reduction of expenditure in the budgets of ministries and central state institutions was planned in the Law Amendments to the Law On State Budget 2009 – in order to achieve budget consolidation for the amount of 500 million lats. The Disbursement Law has been prepared in view of the situation in the State budget (para. 3.1).

The principle of protection of legitimate expectations following from Article 1 of the Constitution does not restrict the legislator's rights to deviate from the previous practice, even if it has been stable. Such a deviation is not only acceptable but also necessary in the cases when a more suitable and obviously more appropriate solution has to be chosen (para. 3.2).

Paragraph One of Article 3 of the Disbursement Law complies with Article 91 of the Constitution, since the purpose of social security benefits is to guarantee means for living to persons when they cannot be actively involved in employment legal relationships due to various reasons and thus to provide means for living by themselves. Whereas employed pensioners and able-bodied persons in active employment are not in an equal and comparable situation in accordance with Paragraph One of Article 3 of the Disbursement Law; therefore, there are no grounds for analyzing whether Paragraph One of Article 3 of the Disbursement Law prescribes different treatment and whether such a different treatment has objective and reasonable grounds (para. 3.3).

Also, the impugned provisions do not violate Article 109 of the Constitution since social rights are special and different rights. The implementation of these rights depends on the economic situation in each country and the available resources (para. 3.5).

Taking into account the above, the Parliament pleaded the Constitutional Court to declare Paragraph One of Article 2 of the Disbursement Law as conformable with Articles 1 and 109 of the Constitution as well as to declare Paragraph One of Article 3 of the Disbursement Law as conformable with Articles 1, 91 105 and 109 of the Constitution.

Answer by the Court to the legal questions and legal reasoning of the Court:

In the area of social rights it is crucial whether the State with its affirmative action can guarantee the satisfaction of a person's individual needs resultant from a particular

fundamental right. At the same time, one should take into account that the provisions of the Constitution basically do not grant persons the rights to a specific amount of social security, and the State should refrain from excessive interference with the financial relations of its citizens. Therefore, the amount of social security granted by the State may vary depending on the amount of funds at the disposal of the State. However, the fundamental rights of persons established by the Constitution are binding to the legislator irrespective of the economic situation in the State (para. 24).

The Disbursement Law restricts the fundamental rights of persons granted by Article 109 of the Constitution (para. 25). The restriction of fundamental rights is established by law, namely, it is included in the Disbursement Law adopted by the Parliament on 16 June 2009 and announced by the President of the State on 30 June 2009. The Case does not contain any materials that would call into question the legitimacy of the adoption of the impugned provisions. At the same time, it should be pointed out that haste in the context of preparation and adoption of the impugned provisions, as well as the fact that society was not duly and timely informed prior to the adoption of these provisions, should be viewed negatively (para. 26).

The Constitutional Court could not regard as justified the opinion of the Applicants – i.e. that the impugned provisions do not have a legitimate end, for the necessary economy is planned solely at the expense of persons with low income. The decrease of budget expenditures reached by means of the impugned provisions is approximately 17.4 % or one-sixth of the total decrease of the State consolidated budget. No doubt, such a decrease has also affected the other positions of the budget along with the branches of activity of the State and national economy. If the amount of pensions had not been reduced, even more significant reductions in the other budget positions would have been in order. The impugned provisions have a legitimate end – securing the sustainability of the social insurance budget by means of balancing its revenues and expenditures, thus ensuring the welfare of society (para. 27).

The principle of proportionality prescribes that, in the cases when a public authority restricts the rights and lawful interests of persons, a reasonable degree of proportionality between the interests of persons and the interests of the State or society should be attained (para. 28). The Constitutional Court agreed that the impugned provisions were directly related to the urgent need to balance the State budget, including the social insurance special budget, in order to diminish the influence of the economic recession on the balance of revenues and expenditures as well as to ensure the sustainability of the pension system. In certain cases, economic crisis can develop to the point when the freedom of action must be granted to the legislator to enable the implementation of remedial measures – even if the latter would infringe the fundamental rights established by the Constitution. In the situation of extremely limited financial resources of the State, the latter has freedom of action to change the conditions for pension disbursement – with the aim of sustaining a just social insurance system. The planned social insurance budget economy in this context is commensurate with the consequences of economic recession – the deficit in the State budget and the overall decline of economic activity in Latvia compared to the showings for 2008. The Constitutional Court had no grounds to call into question the fact that the impugned provisions had helped reduce the expenditures of the State social insurance special budget, correspondingly facilitating the balancing of revenues and expenditures. Therefore, the impugned provisions can help achieve the legitimate end (para. 29).

The Constitutional Court established that the original documents related to the receipt of international loans do not contain information that could be associated with the adoption of the impugned provisions. At the same time, in Sub-paragraph 7.2 of the Supplementary Memorandum of Understanding between the European Community and the Republic of Latvia of 13 July 2009, Latvia pledged to reduce the outlays of pensions by 10 % for non-employed pensioners and by 70% for employed pensioners. With reference to the commitment between the IMF and the Republic of Latvia, the same pledge is included in the Economic Stabilisation and Growth Revival Programme for Latvia adopted by the Parliament on 16 June 2009. However, the fact that the above documents contain the pledge of the Cabinet of Ministers to adopt the impugned provisions does not mean that the international creditors have stipulated these particular conditions. Although the international creditors, within their terms of reference, prescribe for the State the main objectives to be achieved, such as, e.g., the reduction of the State budget for the amount of 500 million lats, including the reduction of the social insurance special budget expenditures, the choices of the most suitable and appropriate means for the attainment of these objectives as well as the possible alternatives are left at the State's own discretion. The Constitutional Court has not received any information attesting that the international creditors stipulated the adoption of the impugned provisions as a prerequisite for granting the loan. The Cabinet of Ministers has indicated that during the negotiations the international creditors repeatedly took notice of the possibility that the sustainability of the social budget would be endangered even in the case of freezing the indexation of pensions. Yet, no evidence of this assertion – for instance, negotiation minutes – have been submitted to the Constitutional Court. It follows from the previous IMF reports that the sustainability of the social budget is endangered and the fiscal risk is caused, for example, by the excessively generous parental allowances (children benefits) and the inconsiderately regulated sickness benefits; moreover, the outflow of large amounts of the social security funds to those social groups that cannot be deemed as disadvantaged or low-income is observable.

Besides, the principle of separation of powers delimits the authority of the Cabinet of Ministers. In accordance with this principle, the Constitution confers the law-making powers – namely, the powers to decide the most important matters for the state – to the Parliament in particular, and, in individual cases, to full-fledged citizens of the Republic of Latvia. The other branches of power are obliged to implement these laws in practice. Determining the relations of the areas of authority of the Parliament and the Cabinet of Ministers, it was admitted that the requirement for the legislator to decide by itself all the matters of the State through legislation has become unrealistic in the complicated living conditions of the present-day society. In order to ensure that the State power be exercised more effectively, it is permissible to deviate from the requirement that the legislator decides all the matters wholly by itself. The optimum effectiveness is achieved when the legislator decides the most important matters through legislation, while delegating to the Cabinet of Ministers the drafting of more detailed regulations and the development of provisions necessary for the implementation of the law in practice.

Although the Cabinet of Ministers is entitled to adopt regulatory enactments, the latter are not permitted to contain such provisions that cannot be deemed as aids for the implementation of the provisions of the law. Thus, it is permissible to delegate the drafting required for the implementation of a law in practice to the Cabinet of Ministers, whereas the Parliament is obliged to decide all the most important matters of the State and public life by itself through legislation. Furthermore, the first part of Article 68 of the Constitution prescribes that all international agreements, which settle matters that may be decided by the legislative process,

shall require ratification by the Parliament. In order to establish whether the Parliament's argumentation for the infringement of the rights of persons can be upheld, one should consider whether the Cabinet of Ministers was entitled to decide without the authorisation from the Parliament the matters pertaining to the international loans, or else the respective commitments are to be taken as settling the matters that had to be decided through legislation and, accordingly, needed the Parliament's approval.

The Constitutional Court could not agree with the statements concerning receipt of the loan found in the letter of the Minister for Justice to the European Commission, namely, that all the approvals and authorisations required for the receipt of the loan have been obtained and that the Agreement does not violate any provision of national legislation, and that the enactment of the Agreement will not violate the requirements of any Latvian legislative act, and that its lawfulness, validity and enactment will not be impugned in the court or any other institution. The Constitutional Court maintained that the conceptual decision with respect to the receipt of the international loan and terms and conditions thereof is to be deemed as an important and significant matter of State and public life, and that, in compliance with the procedure established by the Constitution, it had to be decided by the legislator itself. Although the Parliament has adopted the Economic Stabilisation and Growth Revival Programme for Latvia, has carried out decisions concerning changes to the State budget for 2009 and has adopted the State budget for 2010, these decisions cannot replace the rights established by the Constitution and also the duty to decide on all the substantial matters relating to the aforementioned loans, including the matters concerning the possible authorisation for the Cabinet of Ministers. Therefore, the international commitments assumed by the Cabinet of Ministers cannot by themselves serve as an argument for the restriction of the fundamental rights established by Article 109 of the Constitution (para. 30.1).

The Constitutional Court pointed out that the Agreement of 11 June by itself neither confirms, nor excludes the legitimacy or constitutional compliance of the impugned provisions. Also, the participation of individual organisations or public partners of the government in the preparation of the aforementioned Agreement is not indicative of the constitutional compliance or – just the opposite – non-compliance. The Agreement of 11 June cannot be considered as a legitimate precondition for the adoption of the impugned provisions; rather, it may be viewed a quasi-political pledge signed for different reasons by the individual organisations and public partners of the government along with the political parties constituting the government. The fact of the Agreement is relevant to this Case only insofar as possible alternatives to the impugned provisions have been considered during its preparation. In addition, contrary to the opinion expressed in the replies of the Parliament, the letter of the Cabinet of Ministers and the annotation to the Disbursement Law Draft, the Constitutional Court deemed that the participation of organisations and public partners of the government in the preparation of the Agreement of 11 June was just formal (para. 30.2.1).

The Constitutional Court concluded that the proposed alternatives to the impugned provisions cannot be regarded as viable and accepted, for it was simply impossible to draft adequate alternative proposals in such a short period of time. Likewise, it was impossible to give careful and detailed consideration to such major issues as the potential economic effect and social consequences of these alternative solutions within a few days. Consequently, the Constitutional Court had no grounds for deeming the alternative solutions – which lack the necessary justification and analysis of economic and social consequences – as sufficiently well-considered alternatives to the impugned provisions.

Due to haste and insufficient involvement of experts, the legislator could not duly consider alternative solutions and work out a lenient transition. Among other things, the fact that the Disbursement Law had to be corrected urgently is also indicative of the legislator's inconsiderate action. That is, the disbursement restrictions included in the Disbursement Law pertained to old-age and service pensions. As a consequence, those persons, who had reached the retirement age while still receiving disability pension, received it in full amount, whereas those persons, who had been granted old-age pension instead of disability pension, received it in restricted amount. In other words, the Disbursement Law provided obviously different treatment for persons who were the recipients of disability pension on the one hand (the reduction of pension not applied), and persons who received old-age pension instead of disability pension on the other hand (the reduction of pension applied). Also, with respect to those persons who are subject to Article 2, Paragraph One of the Disbursement Law, the Constitutional Court could not confirm that the legislator has chosen the least restricting means for the attainment of the legitimate end. That is to say, the deduction from pension in the amount of 10 % is applied to all pensioners irrespective of the amount of their pension. As a result of the application of this provision, a pensioner may become a deprived person compelled to apply for social aid. In adopting the impugned provisions, the legislator has not considered with sufficient care the alternatives to these provisions and has not envisaged a more lenient solution. Therefore, the impugned provisions do not comply with Article 109 of the Constitution (para.30.2.2).

Adjudicating whether a reasonable balance has been maintained between the need to protect legitimate expectations of persons and the need to secure public interests, one should consider whether the planned transition to the new legal order is sufficiently lenient. The Constitutional Court has previously established that such a lenient transition may be expressed in the form of setting a reasonable transitional period or granting compensation. Having regard of the duty to protect persons' reasonable confidence in the permanence of legal order ensuing from the principle of legitimate expectations, the State has not only rights; it also has a duty to counter the situations when public interests are seriously jeopardised. If legal order is changed for the common good of society, then such an action is permissible. On this account, a temporary reduction of pension disbursement amount is justified if it is carried out in fair balance with persons' legitimate expectations concerning a specific pension disbursement amount. The ECtHR has also repeatedly drawn attention to the need of ensuring fair balance and commensurate compensation. In the context of this Case, it means that the reduction of pensions could have been implemented only if a legal provision concerning later reimbursement of the deducted money had been simultaneously adopted. In other words, planning such a temporary reduction, the legislator is obliged to ensure its fair reimbursement at a later time. More than that, the State, in proportion to the overall interests of society, had to define the groups of pensioners who would be exempt from this reduction, or to whom a different reduction amount would be applied. The impugned reduction of pensions does not allow a differentiated approach and does not provide either for a later compensation for the deductions, or for an adequate transitional period. Therefore, the impugned provisions do not comply with Article 1 of the Constitution (para. 32).

In view of the aforesaid and the circumstance that, in addition to current expenditures, more than ten million lats per month will still be needed for the restoration of full pension disbursement amounts, as well as the fact that pensions are calculated and disbursed for calendar months, the Constitutional Court maintained that the deductions from pensions made on the basis of the impugned legal provisions are terminable not later than from 1 March 2010 (para. 35.2).

The Court declared Paragraph One of Article 2 and Paragraph One of Article 3 of the Law on State Pension and State Allowance Disbursement in the Period from 2009 to 2012 as incompatible with Articles 1 and 109 of the Constitution of the Republic of Latvia and invalid as of the moment of their adoption, stipulated that the deductions from pensions established in accordance with Paragraph One of Article 2 and Paragraph One of Article 3 of the Law on State Pension and State Allowance Disbursement in the Period from 2009 to 2012 shall be discontinued not later than from 1 March 2010 and ordered the Parliament to establish a reimbursement procedure for deductions made in accordance with Paragraph One of Article 2 and Paragraph One of Article 3 of the Law on State Pension and State Allowance Disbursement in the Period from 2009 to 2012 not later than by 1 March 2010.

Legal effects of the judgment/decision:

The operative part of the judgment becomes a law once announced. This judgment required changes in law.

Shortly describe the main outcome of the judgment/decision and its broader political implications.

Since the Court declared the challenged amendments to Disbursement Law unconstitutional, the legislator had to change the law and reimburse the deductions from the pensions for the persons affected. In general, this was probably the most influential judgment of the Constitutional Court dealing with austerity measures and inter alia led to changes in the procedure how international loans have to be approved (now this procedure involved as well an approval by the Parliament in significant cases).